FINISAR CORP
Form 10-Q
December 04, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended July 29, 2007

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-27999

Finisar Corporation
(Exact name of Registrant as specified in its charter)

Delaware	**94-3038428**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
1389 Moffett Park Drive Sunnyvale, California	**94089**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
408-548-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

At November 30, 2007, there were 308,634,829 shares of the registrant s common stock, $.001 par value, issued and outstanding.

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For the Quarter Ended July 29, 2007

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FINISAR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	July 29, 2007	April 30, 2007
	(in thousands, except per share data)	
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 52,090	$ 56,106
Short-term investments	59,910	56,511
Restricted investments, short-term	625	625
Accounts receivable, net of allowance for doubtful accounts of $1,282 and $1,607 at July 29, 2007 and April 30, 2007	58,434	55,969
Accounts receivable, other	4,724	7,752
Inventories	77,351	77,670
Prepaid expenses	4,352	4,553
Total current assets	257,486	259,186
Long-term investments	17,285	19,855
Property, plant and improvements, net	84,325	84,071
Purchased technology, net	16,622	18,351
Other purchased intangible assets, net	5,157	5,647
Goodwill, net	128,949	128,949
Minority investments	11,250	11,250
Other assets	19,832	19,363
Total assets	$ 540,906	$ 546,672
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 32,825	$ 40,187
Accrued compensation	12,977	10,550
Other accrued liabilities	15,287	12,590
Deferred revenue	5,864	5,473
Current portion of other long-term liabilities	2,299	2,255
Convertible notes	66,950	66,950
Non-cancelable purchase obligations	2,676	2,798
Total current liabilities	138,878	140,803
Long-term liabilities:		
Convertible notes, net of beneficial conversion feature of $5,988 and $7,184 at July 29, 2007 and April 30, 2007	194,262	193,066

Other long-term liabilities	20,346	21,042
Deferred income taxes	6,634	6,090
Total long-term liabilities	221,242	220,198
Commitments and contingent liabilities		
Stockholders equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at July 29, 2007 and April 30, 2007		
Common stock, $0.001 par value, 750,000,000 shares authorized, 308,634,829 shares issued and outstanding at July 29, 2007 and 308,632,366 shares issued and outstanding at April 30, 2007	309	309
Additional paid-in capital	1,532,068	1,529,322
Accumulated other comprehensive income	10,852	11,162
Accumulated deficit	(1,362,443)	(1,355,122)
Total stockholders equity	180,786	185,671
Total liabilities and stockholders equity	$ 540,906	$ 546,672

See accompanying notes

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FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended	
	July 29, 2007	July 30, 2006
	(Unaudited, in thousands, except share and per share data)	
Revenues:		
Optical subsystems and components	$ 96,360	$ 96,043
Network test and monitoring systems	9,375	10,200
Total revenues	105,735	106,243
Cost of revenues	71,703	70,721
Amortization of acquired developed technology	1,729	1,519
Gross profit	32,303	34,003
Operating expenses:		
Research and development	17,502	14,395
Sales and marketing	10,056	8,834
General and administrative	7,991	7,514
Amortization of purchased intangibles	490	299
Total operating expenses	36,039	31,042
Income (loss) from operations	(3,736)	2,961
Interest income	1,415	1,255
Interest expense	(4,246)	(3,921)
Other expense	(133)	(370)
Loss before income taxes and cumulative effect of change in accounting principle	(6,700)	(75)
Provision for income taxes	621	631
Loss before cumulative effect of change in accounting principle	(7,321)	(706)
Cumulative effect of change in accounting principle		(1,213)
Net income (loss)	$ (7,321)	$ 507
Net income (loss) per share basic:		
Before effect of adoption of change in accounting principle	$ (0.02)	$ 0.00
Cumulative effect of change in accounting principle	$	$ 0.00
Net income (loss)	$ (0.02)	$ 0.00
Net income (loss) per share diluted:		
Before effect of adoption of change in accounting principle	$ (0.02)	$ 0.00
Cumulative effect of change in accounting principle	$	$ 0.00

Net income (loss)		$	(0.02)	$	0.00
Shares used in computing net loss per share	basic		308,634		306,499
Shares used in computing net loss per share	diluted		308,634		323,845

See accompanying notes.

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FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	July 29, 2007	July 30, 2006
	(Unaudited, in thousands)	
Operating activities		
Net income (loss)	$ (7,321)	$ 507
Adjustments to reconcile net (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,815	6,708
Stock-based compensation expense	2,759	3,447
Amortization of beneficial conversion feature of convertible notes	1,196	1,148
Amortization of purchased intangibles	490	299
Amortization of acquired developed technology	1,729	1,519
Amortization of discount on restricted securities	(11)	(32)
Gain on sale or retirement of equipment	52	39
Share of losses of equity investee		237
(Gain) loss on sale of equity investment	(117)	
Changes in operating assets and liabilities:		
Accounts receivable	(2,465)	(8,184)
Inventories	(101)	694
Other assets	1,913	(1,171)
Deferred income taxes	544	544
Accounts payable	(7,362)	1,310
Accrued compensation	2,427	798
Other accrued liabilities	2,594	276
Deferred revenue	391	345
Net cash provided by operating activities	3,533	8,484
Investing activities		
Purchases of property, equipment and improvements	(6,010)	(6,117)
Proceeds from sale of property and equipment	39	35
Sale (purchase) of short-term and long-term investments	(1,352)	(3,386)
Proceeds from sale of equity investment	323	
Net cash used in investing activities	(7,000)	(9,468)
Financing activities		
Repayments of liability related to sale-leaseback of building	(86)	(70)
Repayments of borrowings	(463)	(527)
Proceeds from exercise of stock options and employee stock purchase plan		1,692
Net cash provided by (used in) financing activities	(549)	1,095

Net increase (decrease) in cash and cash equivalents	(4,016)	111
Cash and cash equivalents at beginning of period	56,106	63,361
Cash and cash equivalents at end of period	$ 52,090	$ 63,472
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 109	$ 177
Cash paid for taxes	$ 149	$ 48

See accompanying notes.

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FINISAR CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Our optical subsystems consist primarily of transceivers which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances of 70 meters to 200 kilometers. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. Our manufacturing operations are vertically integrated and include internal manufacturing, assembly and test capability. We sell our optical subsystem and component products to manufacturers of storage and networking equipment such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company, Huawei and Qlogic.

We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and, to a lesser degree, to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell these products primarily to leading storage equipment manufacturers such as Brocade, EMC, Emulex, Hewlett-Packard Company, IBM and Qlogic.

Finisar Corporation was incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Finisar s principal executive offices are located at 1389 Moffett Park Drive, Sunnyvale, California 94089, and its telephone number at that location is (408) 548-1000.

2. Summary of Significant Accounting Policies

Interim Financial Information and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of July 29, 2007 and July 30, 2006, and for the three month periods ended July 29, 2007 and July 30, 2006, have been prepared in accordance with U.S generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission, and include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively, Finisar or the Company). Inter-company accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position at July 29, 2007 and July 30, 2006 and its operating results and cash flows for the three month periods ended July 29, 2007 and July 30, 2006. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited financial statements and notes for the fiscal year ended April 30, 2007.

Fiscal Periods

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods).

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Stock-Based Compensation Expense

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors including employee stock options and employee stock purchases

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under the Company s Employee Stock Purchase Plan based on estimated fair values. SFAS 123R requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option pricing model. The Company uses the Black-Scholes option pricing model to determine the fair value of stock based awards under SFAS 123R. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s consolidated statement of operations.

Stock-based compensation expense recognized in the Company s condensed consolidated statement of operations for the three months ended July 29, 2007 and July 30, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of the adoption of SFAS 123R, based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and compensation expense for the stock-based payment awards granted subsequent to April 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Compensation expense for expected-to-vest stock-based awards that were granted on or prior to April 30, 2006 was valued under the multiple-option approach and will continue to be amortized using the accelerated attribution method. Subsequent to April 30, 2006, compensation expense for expected-to-vest stock-based awards is valued under the single-option approach and amortized on a straight-line basis, net of estimated forfeitures.

Revenue Recognition

The Company s revenue transactions consist predominately of sales of products to customers. The Company follows the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104 *Revenue Recognition* and Emerging Issues Task Force (EITF) Issue 00-21 *Revenue Arrangements with Multiple Deliverables*. Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable, and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, the arrangement is divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. In cases where there is objective and reliable evidence of the fair value of the undelivered item in an arrangement but no such evidence for the delivered item, the residual method is used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally recognizes all revenue and cost of revenue for the unit of accounting during the period in which the last undelivered item is delivered.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company s customers and distributors generally do not have return rights. However, the Company has established an allowance for estimated customer returns, based on historical experience, which is netted against revenue.

Sales to certain distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to end customers. Revenue recognition depends on notification from the distributor that product has been sold to the end customer. Also reported by the distributor are product resale price, quantity and end customer shipment information, as well as inventory on hand. Deferred revenue on shipments to distributors reflects the effects of distributor price adjustments and, the amount of gross margin expected to be realized when distributors sell-through products purchased from the Company. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from the Company at which point the Company has a legally enforceable right to collection under normal payment terms.

Segment Reporting

Statement of Financial Accounting Standards (SFAS) No. 131 *Disclosures about Segments of an Enterprise and Related Information* establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company has determined that it operates in two segments consisting of optical subsystems and components and network test and monitoring systems.

Concentrations of Credit Risk

Financial instruments which potentially subject Finisar to concentrations of credit risk include cash, cash equivalents, available-for-sale and restricted investments and accounts receivable. Finisar places its cash, cash equivalents, available-for-sale and restricted investments with high-credit quality financial institutions. Such investments are generally in excess of FDIC insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, Finisar does not require collateral or other security to support customer receivables. Finisar performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have not been material. The Company s five largest customers represented 43.5% and 33.3% of total accounts receivable at July 29, 2007 and April 30, 2007, respectively.

Current Vulnerabilities Due to Certain Concentrations

Finisar sells products primarily to customers located in North America. During the three months ended July 29, 2007 and July 30, 2006, sales to the top five optical subsystems and components customers represented 45.2% and 43.8% of total revenues, respectively. One customer represented more than 10% of total revenues during each of these periods.

Included in the Company s condensed consolidated balance sheet at July 29, 2007, are the net assets of the Company s manufacturing operations, substantially all of which are located in Malaysia and which total approximately $60.6 million.

Foreign Currency Translation

The functional currency of the Company s foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

Research and Development

Research and development expenditures are charged to operations as incurred.

Advertising Costs

Advertising costs are expensed as incurred. Advertising is used infrequently in marketing the Company s products. Advertising costs were $13,000 and $8,500 in the three months ended July 29, 2007 and July 30, 2006, respectively.

Shipping and Handling Costs

The Company records costs related to shipping and handling in cost of sales for all periods presented.

Cash and Cash Equivalents

Finisar s cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. Finisar considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents.

Investments

Available-for-Sale

Available-for-sale investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and equity securities. Pursuant to SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*, the Company has classified its investments as available-for-sale. Available-for-sale securities are stated at market value, which approximates fair value, and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. A decline in the market value of the security below cost that is deemed other than temporary is charged to earnings, resulting in the establishment of a new cost basis for the security.

Restricted Investments

Restricted investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and investments held in escrow under the terms of the Company s convertible subordinated notes. In accordance with SFAS 115, the Company has classified its restricted investments as held-to-maturity.
Held-to-maturity securities are stated at amortized cost.

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Other

The Company uses the cost method of accounting for investments in companies that do not have a readily determinable fair value in which it holds an interest of less than 20% and over which it does not have the ability to exercise significant influence. For entities in which the Company holds an interest of greater than 20% or in which the Company does have the ability to exercise significant influence, the Company uses the equity method. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. The Company s policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. The Company s minority investments in private companies are generally made in exchange for preferred stock with a liquidation preference that is intended to help protect the underlying value of its investment.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities, approximate fair value because of their short maturities. As of July 29, 2007 and April 30, 2007, the fair value of the Company s convertible subordinated debt was approximately $276.7 million and $285.2 million, respectively.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

The Company permanently writes down the cost of inventory that the Company specifically identifies and considers obsolete or excessive to fulfill future sales estimates. The Company defines obsolete inventory as inventory that will no longer be used in the manufacturing process. Excess inventory is generally defined as inventory in excess of projected usage and is determined using management s best estimate of future demand, based upon information then available to the Company. The Company also considers: (1) parts and subassemblies that can be used in alternative finished products, (2) parts and subassemblies that are likely to be engineered out of the Company s products, and (3) known design changes which would reduce the Company s ability to use the inventory as planned.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three years to seven years except for buildings, which are depreciated over 40 years. Land is carried at acquisition cost and not depreciated. Leased land costs are depreciated over the life of the lease.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets result from acquisitions accounted for under the purchase method. Amortization of intangibles has been provided on a straight-line basis over periods ranging from one to nine years. The amortization of goodwill ceased with the adoption of SFAS No. 142 beginning in the first quarter of fiscal 2003.

Accounting for the Impairment of Long-Lived Assets

The Company periodically evaluates whether changes have occurred to long-lived assets that would require revision of the remaining estimated useful life of the assets or render them not recoverable. If such circumstances arise, the Company uses an estimate of the undiscounted value of expected future operating cash flows to determine whether the long-lived assets are impaired. If the aggregate undiscounted cash flows are less than the carrying amount of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows.

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Computation of Net Loss Per Share

Basic and diluted net loss per share is presented in accordance with SFAS No. 128 *Earnings Per Share* for all periods presented. Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from options and warrants (under the treasury stock method) and convertible notes (on an as-if-converted basis) outstanding during the period.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended	
	July 29, 2007	July 30, 2006
	(in thousands, except per share amounts)	
Numerator:		
Net income (loss)	$ (7,321)	$ 507
Denominator for basic net income (loss) per share:		
Weighted-average shares outstanding total	308,634	306,499
Weighted-average shares outstanding basic	308,634	306,499
Effect of dilutive securities:		
Weighted-average shares outstanding subject to repurchase		4
Weighted-average shares outstanding employee stock options		17,026
Weighted-average shares outstanding outstanding warrants		316
Weighted-average shares outstanding diluted	308,634	323,845
Basic net income (loss) per share	$ (0.02)	$ 0.00
Diluted net income (loss) per share	$ (0.02)	$ 0.00
Common stock equivalents related to potentially dilutive securities excluded from computation above because they are anti-dilutive:		
Employee stock options	17,017	
Conversion of convertible subordinated notes	35,117	58,647
Conversion of convertible notes	4,661	
Warrants assumed in acquisition	465	40
Potentially dilutive securities	57,260	58,687

Comprehensive Income

SFAS No. 130 *Reporting Comprehensive Income* establishes rules for reporting and display of comprehensive income and its components. SFAS No. 130 requires unrealized gains or losses on the Company s available-for-sale securities and foreign currency translation adjustments to be included in comprehensive income.

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The components of comprehensive loss for the three months ended were as follows (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2006
Net income (loss)	$ (7,321)	$ 507
Foreign currency translation adjustment	18	(585)
Change in unrealized gain (loss) on securities, net of reclassification adjustments for realized loss	(328)	11,985
Comprehensive income (loss)	$ (7,631)	$ 11,907

The components of accumulated other comprehensive income (loss), net of taxes, were as follows (in thousands):

	July 29, 2007	April 30, 2007
Net unrealized gains on available-for-sale securities	$ 4,741	$ 5,069
Cumulative translation adjustment	6,111	6,093
Accumulated other comprehensive income	$ 10,852	$ 11,162

Income Taxes

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An interpretation of FASB Statement No. 109,* (FIN 48) on May 1, 2007. FIN 48 is an interpretation of FASB Statement 109, *Accounting for Income Taxes,* and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a more likely than not threshold. In accordance with our accounting policy, we recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. This policy did not change as a result of our adoption on FIN 48.

3. Inventories

Inventories consist of the following (in thousands):

	July 29, 2007	April 30, 2007
Raw materials	$ 20,115	$ 21,597
Work-in-process	28,292	27,336
Finished goods	28,944	28,737
Total inventory	$ 77,351	$ 77,670

During the three months ended July 29, 2007 and July 30 2006, the Company recorded charges of $3.8 million and $3.4 million, respectively, for excess and obsolete inventory, and sold inventory that was written-off in previous periods with an approximate cost of $1.7 million and $1.1 million, respectively. As a result, cost of revenue associated with the sale of this inventory was zero.

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5. Property and Equipment

Property and equipment consist of the following (in thousands):

	July 29, 2007	April 30, 2007
Land	$ 9,747	$ 9,747
Buildings	11,365	11,365
Computer equipment	38,148	37,475
Office equipment, furniture and fixtures	3,241	3,196
Machinery and equipment	140,028	135,238
Leasehold improvements	13,207	12,795
Contruction-in-process	572	444
Total	216,308	210,260
Accumulated depreciation and amortization	(131,983)	(126,189)
Property, equipment and improvements (net)	$ 84,325	$ 84,071

6. Income Taxes

The Company recorded a provision for income taxes of $621,000 and $631,000, respectively, for the three months ended July 29, 2007 and 2006. The provision for income tax expense for the three months ended July 29, 2007 and 2006 includes non-cash charges of $544,000 for deferred tax liabilities that were recorded for tax amortization of goodwill for which no financial statement amortization has occurred under generally accepted accounting principles, as promulgated by SFAS 142.

The Company records a valuation allowance against its deferred tax assets for each period in which management concludes that it is more likely than not that the deferred tax assets will not be realized. Realization of the Company s net deferred tax assets is dependent upon future taxable income the amount and timing of which are uncertain. Accordingly, the Company s net deferred tax assets as of July 29, 2007 have been fully offset by a valuation allowance.

A portion of the valuation allowance for deferred tax assets at July 29, 2007 relates to tax net operating loss carry forwards and other tax attributes of acquired companies the tax benefit of which, when realized, will first reduce goodwill, then other non-current intangible assets arising from the acquired companies, and thereafter, income tax expense.

Effective May 1, 2007, we adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition rules.

The adoption of FIN 48 did not result in an adjustment to beginning retained earnings and did not have any impact on our results of operations. As of the date of adoption, the Company had $9.6 million of unrecognized tax benefits. Excluding the effects of recorded valuation allowances for deferred tax assets, $7.2 million of the unrecognized tax benefits would favorably impact the effective tax rate in future periods if recognized and $1.5 million of unrecognized tax benefits would reduce goodwill if recognized.

As of date of adoption the Company has not recorded any income tax liabilities for unrecognized tax positions as no cash payments are anticipated. There have been no significant changes during the quarter ended July 29, 2007.

The Company records interest and penalties related to unrecognized tax benefits in income tax expense. As of date of adoption there were no accrued interest or penalties related to uncertain tax positions.

As a result of our global operations, the Company or its subsidiaries file income tax returns in various jurisdictions including U.S. federal, U.S. state, and certain foreign jurisdictions. The Company s U.S. federal and state income tax returns are generally not subject to examination by the tax authorities for tax years before 2003. For all federal and state net operating loss and credit carryovers, the statute of limitations does not begin until the carryover items are utilized. The taxing authorities can examine the validity of the carryover items and if necessary, adjustments may be made to the carryover items. The Company s Malaysia, Singapore, and China income tax returns are generally not subject to examination by the tax authorities for tax years before 2003, 2001, and 2003, respectively. For state purposes, we are currently under examination, however, we do not expect any significant change to our unrecognized state tax benefits within the next year.

There are no unrecognized tax benefits at July 29, 2007 related to tax positions, interest, and penalty for which it is reasonably possible that the statute of limitations will expire within the next twelve months.

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6. Purchased Intangible Assets

The following table reflects intangible assets subject to amortization as of July 29, 2007 and April 30, 2007 (in thousands):

	July 29, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 111,846	($95,224)	$ 16,622
Trade name	3,697	(3,216)	481
Customer relationships	6,964	(2,288)	4,676
Total	$ 122,507	($100,728)	$ 21,779

	April 30, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 111,846	($93,495)	$ 18,351
Trade name	3,697	(3,171)	526
Customer relationships	6,964	(1,843)	5,121
Total	$ 122,507	($98,509)	$ 23,998

Estimated remaining amortization expense for each of the next five fiscal years ending April 30, is as follows (in thousands):

Year	Amount
2008	$ 6,030
2009	5,481
2010	3,811
2011	3,336
2012 and beyond	3,121
	$ 21,779

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7. Investments

Available-for-Sale Securities

The following is a summary of the Company s available-for-sale investments as of July 29, 2007 and April 30, 2007 (in thousands):

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of July 29, 2007				
Debt:				
Corporate	$ 63,941	$ 7	$ (63)	$ 63,885
Government agency	12,203	19	(10)	12,212
Mortgage-backed	3,402		(20)	3,382
Municipal	300		(2)	298
	$ 79,846	$ 26	$ (95)	$ 79,777
Equity:				
Corporate	$ 3,400	$ 4,811	$	$ 8,211
Total investments	$ 83,246	$ 4,837	$ (95)	$ 87,988
Reported as:				
Cash equivalents	$ 10,793	$	$	$ 10,793
Short-term investments	59,960	6	(56)	59,910
Long-term investments	12,493	4,831	(39)	17,285
Total	$ 83,246	$ 4,837	$ (95)	$ 87,988
As of April 30, 2007				
Debt:				
Corporate	$ 62,643	$ 9	$ (94)	$ 62,558
Government agency	12,200	26	(18)	12,208
Mortgage-backed	3,626	1	(21)	3,606
Municipal	300		(3)	297
Total	$ 78,769	$ 36	$ (136)	$ 78,669
Equity:				
Corporate	$ 3,607	$ 5,169	$	$ 8,776

Total investments	$	82,376	$	5,205	$	(136)	$ 87,445
Reported as:							
Cash equivalents	$	11,079	$		$		$ 11,079
Short-term investments		56,603		3		(95)	56,511
Long-term investments		14,694		5,202		(41)	19,855
Total	$	82,376	$	5,205	$	(136)	$ 87,445

The gross realized losses for the three months ended July 29, 2007 and July 30, 2006 were immaterial. Realized gains and losses were calculated based on the specific identification method.

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Restricted Securities

The Company has purchased and pledged to a collateral agent, as security for the exclusive benefit of the holders of the Company s 2 1/2% convertible subordinated notes, U.S. government securities, which will be sufficient upon receipt of scheduled principal and interest payments thereon, to provide for the payment in full of the first eight scheduled interest payments due on such outstanding convertible subordinated notes. These restricted securities are classified as held to maturity and are recorded on the Company s consolidated balance sheet at amortized cost. The following table summarizes the Company s restricted securities as of July 29, 2007 and April 30, 2007 (in thousands):

	Amortized Cost	Gross Unrealized Gain/(Loss)	Market Value
As of July 29,2007			
Government agency	$ 625	$	$ 625
Classified as:			
Short term less than 1 year	625		625
Total	$ 625	$	$ 625
As of April 30, 2007			
Government agency	$ 625	$	$ 625
Classified as:			
Short term less than 1 year	625		625
Total	$ 625	$	$ 625

8. Minority Investments

Minority investments is comprised of several investments in other companies accounted for under the cost method.

Cost Method Investments

Included in minority investments at July 29, 2007 and April 30, 2007 are cost method investments of $11.3 million for each period.

9. Stockholders Equity

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its sub-plan, the International Employee Stock Purchase Plan (together the Purchase Plan), under which 16,750,000 shares of the Company s common stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of common stock at a discount of 15% to the market value at certain plan-defined dates. During the three months ended July 29, 2007, the Company did not issue any shares under this plan. During the three months ended July 30, 2006, the Company issued 860,025 shares under this plan. At July 29, 2007, 11,060,097 shares were available for issuance under the Purchase Plan.

The Purchase Plan permits eligible employees to purchase Finisar common stock through payroll deductions, which may not exceed 20% of the employee s total compensation. Stock may be purchased under the plan at a price equal to 85% of the fair market value of Finisar common stock on either the first or the last day of the offering period, whichever is lower.

Employee Stock Option Plans

During fiscal 1989, Finisar adopted the 1989 Stock Option Plan (the 1989 Plan). The 1989 Plan expired in April 1999 and no further option grants have been made under the 1989 Plan since that time. Options granted under the 1989 Plan had an exercise price of not less than 85% of the fair value of a share of common stock on the date of grant (110% of the fair value in certain instances) as determined by the board of directors. Options generally vested over five years and had a maximum term of 10 years.

Finisar s 1999 Stock Option Plan was adopted by the board of directors and approved by the stockholders in September 1999. An amendment and restatement of the 1999 Stock Option Plan, including renaming it the 2005 Stock Incentive Plan (the 2005 Plan), was approved by the board of directors in September 2005 and by the stockholders in October 2005. A total of 21,000,000 shares of common stock were initially reserved for issuance under the 2005 Plan. The share reserve automatically increases on May 1 of each calendar year by a number of shares equal to 5% of the number of shares of Finisar s common stock issued and outstanding as of the immediately preceding April 30, subject to certain restrictions on the aggregate maximum number of shares that may be issued pursuant to incentive stock options. The types of stock-based awards available under the 2005 Plan includes stock options, stock appreciation rights, restricted stock units and other stock-based awards which vest upon the attainment of designated performance goals or the satisfaction of specified service requirements or, in the case of certain restricted stock units or other stock-based awards, become payable upon the expiration of a designated time period following such vesting events. To date, only stock options have been granted under the 2005 Plan. Options generally vest over five years and have a maximum term of 10 years. As of July 29, 2007, there were no shares subject to repurchase and at July 30, 2006, 3,700 shares were subject to repurchase.

A summary of activity under the Company s employee stock option plans is as follows:

	Options Available for Grant	**Options Outstanding**			
Options for Common Stock	**Number of Shares**	**Number of Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term (In years)**	**Aggregate Intrinsic Value (1) ($000 s)**
Balance at April 30, 2007	28,815,162	46,119,115	$ 2.58		
Increase in authorized shares	15,431,618				
Options granted	(2,387,500)	2,387,500	$ 3.91		
Options exercised			$ 0.00		
Options canceled	1,604,323	(1,604,323)	$ 2.58		
Balance at July 29, 2007	43,463,603	46,902,292	$ 2.65	6.74	$ 70,565

(1) Represents the difference between the exercise price and the value of Finisar common stock at July 27, 2007.

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company s closing stock price of $3.70 as of July 27, 2007, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average remaining contractual life of options exercisable is 5.7 years. The total number of in-the-money options exercisable as of July 29, 2007 was 21.5 million.

Valuation and Expense Information under SFAS 123(R)

The following table summarizes stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123(R) for the three months ended July 29, 2007 and July 30, 2006 which was reflected in our operating results as follows (in thousands):

	Three Months Ended	
	July 29,	**July 30,**

	2007	2006
	(Unaudited, in thousands)	
Cost of revenues	$ 722	$ 1,136
Research and development	955	1,176
Sales and marketing	451	529
General and administrative	631	607
Total	$ 2,759	$ 3,448

The total stock-based compensation capitalized as part of inventory as of July 29, 2007 was $397,000.

As of July 29, 2007, total compensation cost related to unvested stock options not yet recognized was $19.1 million which is expected to be recognized over the next 29 months on a weighted-average basis.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model and the straight-line attribution approach with the following weighted-average assumptions:

	Employee Stock Option Plans		Employee Stock Purchase Plan	
	July 29, 2007	July 30, 2006	July 29, 2007 (1)	July 30, 2006
Weighted average fair value per share	$ 2.86	$ 3.47	n/a	$ 0.90
Expected term (in years)	5.44	5.15	n/a	0.50
Volatility	88%	104%	n/a	67%
Risk-free interest rate	4.60%	5.07%	n/a	4.40%
Dividend yield	0.00%	0.00%	n/a	0.00%

(1) During the quarter ended July 29, 2007, the Company s Purchase Plan was not in effect.

Accuracy of Fair Value Estimates

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and the stock price volatility. The assumptions listed above represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our recorded and pro forma stock-based compensation expense could have been materially different from that depicted above. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be materially different.

10. Segments and Geographic Information

The Company designs, develops, manufactures and markets optical subsystems, components and test and monitoring systems for high-speed data communications. The Company views its business as having two principal operating segments, consisting of optical subsystems and components and network test and monitoring systems.

Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for storage area networks (SANs) and local area networks (LANs) and metropolitan access network (MAN) applications. Optical subsystems also include multiplexers, de-multiplexers and optical add/drop modules for use in MAN applications. Optical components consist primarily of packaged lasers and photo-detectors which are incorporated in transceivers, primarily for LAN and SAN applications. Network test and monitoring systems include products designed to test the reliability and performance of equipment for a variety of protocols including Fibre Channel, Gigabit Ethernet, 10 Gigabit Ethernet, iSCSI, SAS and SATA. These test and monitoring systems are sold to both manufacturers and end-users of the equipment.

Both of the Company s operating segments and its corporate sales function report to the President and Chief Executive Officer. Where appropriate, the Company charges specific costs to these segments where they can be identified and allocates certain manufacturing costs, research and development, sales and marketing and general and administrative costs to these operating segments, primarily on the basis of manpower levels or a percentage of sales. The Company does not allocate income taxes, non-operating income, acquisition related costs, stock compensation, interest income and interest expense to its operating segments. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. There are no intersegment sales.

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Information about reportable segment revenues and income/(losses) are as follows (in thousands):

	Three Months Ended	
	July 29, 2007	**July 30, 2006**
Revenues:		
Optical subsystems and components	$ 96,360	$ 96,043
Network test and monitoring systems	9,375	10,200
Total revenues	$ 105,735	$ 106,243
Depreciation and amortization expense:		
Optical subsystems and components	$ 6,538	$ 6,424
Network test and monitoring systems	277	284
Total depreciation and amortization expense	$ 6,815	$ 6,708
Operating income (loss):		
Optical subsystems and components	$ (441)	4,970
Network test and monitoring systems	(1,076)	(191)
Total operating income (loss)	(1,517)	4,779
Unallocated amounts:		
Amortization of acquired developed technology	(1,729)	(1,519)
Amortization of purchased intangibles	(490)	(299)
Interest income (expense), net	(2,831)	(2,666)
Other non-operating income (expense), net	(133)	(370)
Total unallocated amounts	(5,183)	(4,854)
Loss before income taxes and cumulative effect	$ (6,700)	$ (75)

The following is a summary of total assets by segment (in thousands):

	July 29, 2007	**April 30, 2007**
Optical subsystems and components	$ 385,531	$ 392,260
Network test and monitoring systems	82,108	76,885
Other assets	73,267	77,527
	$ 540,906	$ 546,672

Short-term, restricted and minority investments are the primary components of other assets in the above table.

The following is a summary of operations within geographic areas based on the location of the entity purchasing the Company s products (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2007
Revenues from sales to unaffiliated customers:		
United States	$ 34,176	$ 40,425
Rest of the world	71,559	65,818
	$ 105,735	$ 106,243

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Revenues generated in the United States are all from sales to customers located in the United States.

The following is a summary of long-lived assets within geographic areas based on the location of the assets (in thousands):

	July 29, 2007	April 30, 2007
Long-lived assets		
United States	$ 234,943	$ 237,691
Malaysia	27,884	26,589
Rest of the world	3,308	3,351
	$ 266,135	$ 267,631

The following is a summary of capital expenditures by reportable segment (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2007
Optical subsystems and components	$ 5,900	$ 6,058
Network test and monitoring systems	110	59
Total capital expenditures	$ 6,010	$ 6,117

11. Warranty

The Company generally offers a one-year limited warranty for all of its products. The specific terms and conditions of these warranties vary depending upon the product sold and the end customer. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs based on revenue recognized. Factors that affect the Company s warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company s warranty liability during the following period were as follows (in thousands):

	Three Months Ended July 29, 2007
Beginning balance at April 30, 2007	$ 1,818
Additions during the period based upon product sold	484
Settlements	388
Changes in liability for pre-existing warranties, including expirations	(853)
Ending balance at July 29, 2007	$ 1,837

12. Sales of Accounts Receivable

The Company has an agreement with Silicon Valley Bank to sell certain trade receivables. In these non-recourse sales, the Company removes the sold receivables from its books and records no liability related to the sale, as the Company has assessed that the sales should be accounted for as true sales in accordance with SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* During the three months ended July 29, 2007 and July 30, 2006, the Company sold approximately $5.3 million and $4.2 million, respectively, of its trade receivables to Silicon Valley Bank under the terms of this agreement.

13. Restructuring

As of July 29, 2007, $845,000 of committed facility payments remain accrued and are expected to be fully utilized by the end of fiscal 2011. This amount relates to restructuring activities associated with the Company s Sunnyvale and Scotts Valley facilities that took place in fiscal 2006.

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14. Pending Litigation

Matters Related to Historical Stock Option Grant Practices

On November 30, 2006, the Company announced that it had undertaken a voluntary review of its historical stock option grant practices subsequent to its initial public offering in November 1999. The review was initiated by senior management, and preliminary results of the review were discussed with the Audit Committee of the Company s Board of Directors. Based on the preliminary results of the review, senior management concluded, and the Audit Committee agreed, that it was likely that the measurement dates for certain stock option grants differed from the recorded grant dates for such awards and that the Company would likely need to restate its historical financial statements to record non-cash charges for compensation expense relating to some past stock option grants. The Audit Committee thereafter conducted a further investigation and engaged independent legal counsel and financial advisors to assist in that investigation. The Audit Committee concluded that measurement dates for certain option grants differ from the recorded grant dates for such awards. The Company s management, in conjunction with the Audit Committee, conducted a further review to finalize revised measurement dates and determine the appropriate accounting adjustments to its historical financial statements, which are reflected in this report. The announcement of the investigation, and related delays in filing this quarterly report on Form 10-Q for the quarter ended July 29, 2007, the Company s quarterly reports on Form 10-Q for the quarters ended October 29, 2006 and January 28, 2007, and its annual report on Form 10-K for the fiscal year ended April 30, 2007, have resulted in the initiation of regulatory proceedings as well as civil litigation and claims. Financial information included in the Company s reports on Form 10-K, Form 10-Q and Form 8-K filed by Finisar prior to November 28, 2006 and the related reports of its independent registered public accounting firm, included in the Forms 10-K, and all earnings and press releases and similar communications issued by the Company prior to November 28, 2006 should not be relied upon and are superseded in their entirety by the annual report of Form 10-K for the fiscal year ended April 30, 2007, the other reports on Form 10-Q, including this report, and Form 8-K filed by the Company with the Securities and Exchange Commission on or after November 28, 2006.

Nasdaq Determination of Non-compliance

On December 13, 2006, the Company received a Staff Determination notice from the Nasdaq Stock Market stating that the Company was not in compliance with Marketplace Rule 4310(c)(14) because it did not timely file the October 10-Q and, therefore, that its common stock was subject to delisting from the Nasdaq Global Select Market. The Company received similar Staff Determination Notices with respect to its failure to timely file the January 10-Q, the July 10-Q and the 2007 10-K. In response to the original Staff Determination Notice, the Company requested a hearing before a Nasdaq Listing Qualifications Panel (the Panel) to review the Staff Determination and to request additional time to comply with the filing requirements pending completion of the Audit Committee s investigation. The hearing was held on February 15, 2007. The Company thereafter supplemented its previous submission to Nasdaq to include the subsequent periodic reports in its request for additional time to make required filings. On April 4, 2007, the Panel granted the Company additional time to comply with the filing requirements until June 11, 2007 for the October 10-Q and until July 3, 2007 for the January 10-Q. The Company appealed the Panel s decision to the Nasdaq Listing and Hearing Review Counsel (the Listing Council), seeking additional time to make the filings. On May 18, 2007, the Listing Council agreed to review the Panel s April 4, 2007 decision and stayed that decision pending review of the Company s appeal. On October 5, 2007, the Listing Council granted the Company an exception until December 4, 2007 to file its delinquent periodic reports and restatement. On November 26, 2007, the Company filed an appeal with the Nasdaq Board of Directors seeking a review of the Listing Council s decision and a stay of the decision, including the Listing Council s December 4, 2007 deadline. On November 30, 2007, the Nasdaq Board of Directors agreed to review the Listing Council s decision and stayed the decision pending further consideration by the Board. The Company believes that the filing of this report, and the simultaneous filing of its other delinquent reports on Form 10-Q and Form 10-K, will satisfy the conditions of the Listing Council s decision and that its common stock will continue to be listed on the Nasdaq Global Select Market.

Securities and Exchange Commission Inquiry

In November 2006, the Company informed the staff of the Securities and Exchange Commission (the SEC) of the voluntary investigation that had been undertaken by the Audit Committee of the Board of Directors. The Company was subsequently notified by the SEC that the SEC was conducting an informal inquiry regarding the Company s historical stock option grant practices. The Company is cooperating with the SEC s review.

Stock Option Derivative Litigation

Following the announcement by the Company on November 30, 2006 that the Audit Committee of the Board of Directors had voluntarily commenced an investigation of the Company s historical stock option grant practices, the Company was named as a nominal defendant in several shareholder derivative cases. These cases have been consolidated into two proceedings pending in federal and state courts in California. The federal court cases have been consolidated in the United States District Court for the Northern District of California. The state court cases have been consolidated in the Superior Court for the State of California for the County of Santa Clara. Plaintiffs in all cases have alleged that certain current or former officers and directors of the Company caused it to grant stock options at less than fair market value, contrary to the Company s public statements (including its financial statements), and that, as a result, those officers and directors are liable to the Company. No specific amount of damages has been alleged, and by the nature of the lawsuits no damages will be alleged, against the Company. On May 22, 2007, the state court granted the Company s motion to stay the state court action pending resolution of the consolidated federal court action. On June 12, 2007, the plaintiffs in the federal court case filed an amended complaint to reflect the results of the stock option investigation announced by the Audit Committee in June 2007. On August 28, 2007, the Company and the individual defendants filed motions to dismiss the complaint. A hearing on the motions has been set for January 11, 2008.

Trust Indenture Litigation

On January 4, 2007, the Company received three substantially identical purported notices of default from U.S. Bank Trust National Association, as trustee (the Trustee) for the Company s 2 1/2% Convertible Senior Subordinated Notes due 2010, its 2 1/2% Convertible Subordinated Notes due 2010 and its 5 1/4% Convertible Subordinated Notes due 2008 (collectively, the Notes). The notices asserted that the Company s failure to timely file the October 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the three indentures between the Company and the Trustee governing the respective series of Notes (the Indentures). The notices each indicated that, if the Company did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. As previously reported, the Company had delayed filing the October 10-Q pending the completion of the review of its historical stock option grant practices conducted by the Audit Committee of its Board of Directors.

The Company believes that it is not in default under the terms of the Indentures. The Company contends that the plain language of each Indenture requires only that the Company file with the Trustee reports that have actually been filed with the SEC, and that, since the October 10-Q had not yet been filed with the SEC, the Company was under no obligation to file it with the Trustee.

In anticipation of the expiration of the 60-day cure period under the notices on March 5, 2007, and the potential assertion by the Trustee or the noteholders that an Event of Default had occurred and a potential attempt to accelerate payment on one or more series of the Notes, on March 2, 2007, the Company filed a lawsuit in the Superior Court for the State of California for the County of Santa Clara against U.S. Bank Trust National Association, solely in its capacity as Trustee under the Indentures, seeking a judicial declaration that the Company is not in default under the three Indentures, based on the Company s position as described above. The Trustee filed an answer to the complaint generally denying all allegations and also filed a notice of removal of the state case to the United States District Court for the Northern District of California. On October 12, 2007, the action was remanded back to the state court in which it was commenced because the Trustee s notice of removal was not timely.

As expected, on March 16, 2007, the Company received three additional notices from the Trustee asserting that Events of Default under the Indentures had occurred and were continuing based on the Company s failure to cure the alleged default within the 60-day cure period.

On April 24, 2007, the Company received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that the Company s failure to timely file the January 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. The notices each indicated that, if the Company did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. The Company believes that it is not in default under the terms of the Indentures for the reasons described above.

On June 21, 2007, the Company filed a second declaratory relief action against the Trustee in the Superior Court of California for the County of Santa Clara. The second action is essentially identical to the first action filed on March 2, 2007 except that it covers the notices asserting Events of Default received in April 2007 and any other notices of default that the Trustee may deliver in the future with respect to the Company s delay in filing, and providing copies to the Trustee, of periodic reports with the SEC. The Trustee filed an answer to the complaint generally denying all allegations and filed a notice of removal to the United States District Court for the Northern District of California. The Company has filed a motion to remand to state court, which was heard and taken under submission on November 2, 2007.

On July 9, 2007, the Company received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that the Company s failure to timely file this Form 10-K report with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. As before, the notices each indicated that, if the Company did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. The Company believes that it is not in default under the terms of the Indentures for the reasons described above.

To date, neither the Trustee nor the holders of at least 25% in aggregate principal amount of one or more series of the Notes have declared all unpaid principal, and any accrued interest, on the Notes to be due and payable, although the Trustee stated in the notices that it reserved the right to exercise all available remedies. As of October 31, 2007, there was $250.3 million in aggregate principal amount of Notes outstanding and an aggregate of approximately $558,000 in accrued interest.

Patent Litigation

DirecTV Litigation

On April 4, 2005, the Company filed an action for patent infringement in the United States District Court for the Eastern District of Texas against the DirecTV Group, Inc., DirecTV Holdings, LLC, DirecTV Enterprises, LLC, DirecTV Operations, LLC, DirecTV, Inc., and Hughes Network Systems, Inc. (collectively, DirecTV). The lawsuit involves the Company s U.S. Patent No. 5,404,505 (the 505 patent), which relates to technology used in information transmission systems to provide access to a large database of information. On June 23, 2006, following a jury trial, the jury returned a verdict that the Company s patent had been willfully infringed and awarded the Company damages of $78,920,250. In a post-trial hearing held on July 6, 2006, the Court determined that, due to DirecTV s willful infringement, those damages would be enhanced by an additional $25 million. Further, the Court awarded the Company pre-judgment interest on the jury s verdict in the amount of 6% compounded annually from April 4, 1999, amounting to approximately $13.4 million. Finally, the Court awarded the Company costs of $147,282 associated with the litigation. The Court declined to award the Company its attorney s fees. The Court denied the Company s motion for injunctive relief, but ordered DirecTV to pay a compulsory ongoing license fee to the Company at the rate of $1.60 per set-top box activated by or on behalf of DirecTV for the period beginning June 16, 2006 through the duration of the patent, which expires in April 2012. The Court entered final judgment in favor of the Company and against DirecTV on July 7, 2006. On September 1, 2006, the Court denied DirecTV s post-trial motions seeking to have the jury verdict set aside or reversed and requesting a new trial on a number of grounds. In another written post-trial motion, DirecTV asked the Court to allow DirecTV to place any amounts owed the Company under the compulsory license into an escrow account pending the outcome of any appeal and for those amounts to be refundable in the event that DirecTV prevails on appeal. The Court granted DirecTV s motion and payments under the compulsory license are being made into an escrow account pending the outcome of the appeal. As of October 12, 2007, DirecTV has deposited approximately $28 million into escrow. These escrowed funds represent DirecTV s compulsory royalty payments for the period from June 17, 2006 through September 30, 2007.

DirecTV has appealed to the United States Court of Appeals for the Federal Circuit. In its appeal, DirecTV raised issues related to claim construction, infringement, invalidity, willful infringement and enhanced damages. The Company cross-appealed raising issues related to the denial of the Company s motion for permanent injunction, the trial court s refusal to enhance future damages for willfulness and the trial court s determination that some of the asserted patent claims are invalid. The appeals have been consolidated. The parties were ordered to participate in the appellate court s mandatory mediation program, which occurred on February 13, 2007 without resolution. The parties have filed their respective briefs with the appellate court. A neutral third party, New York Intellectual Property Law Association (NYIPLA) filed an *amicus* brief urging the appellate court to vacate the portion of trial court s judgment denying the Company s motion for a permanent injunction and ordering DirecTV to pay royalties pursuant to a compulsory license. Over DirecTV s objection, the appellate court accepted NYIPLA s *amicus* brief. On November 19, 2007, the Court of Appeals denied NYIPLA s motion to file a reply brief. Oral arguments have been set for January 7, 2008. Subsequent to the oral arguments, it is anticipated that a decision from the appellate court will issue between March 2008 and November 2008.

Comcast Litigation

On July 7, 2006, Comcast Cable Communications Corporation, LLC (Comcast) filed a complaint against the Company in the United States District Court, Northern District of California, San Francisco Division. Comcast seeks a declaratory judgment that the Company s 505 patent is not infringed and is invalid. The 505 patent is the same patent alleged by the Company in its lawsuit against DirecTV. The Company s motion to dismiss the declaratory judgment action was denied on November 9, 2006. As a result, on November 22, 2006, the Company filed an answer and counterclaim alleging that Comcast infringes the 505 patent and seeking damages to be proven at trial. The court held a claim construction hearing and, on April 6, 2007, issued its claim construction ruling. Discovery is now underway. The parties have been ordered to a mediation and settlement conference on December 13, 2007. A jury trial has been scheduled for March 3, 2008.

EchoStar Litigation

On July 10, 2006, EchoStar Satellite LLC, EchoStar Technologies Corporation and NagraStar LLC (collectively EchoStar) filed an action against the Company in the United States District Court for the District of Delaware seeking a declaration that EchoStar does not infringe, and has not infringed, any valid claim of the Company s 505 patent. The 505 patent is the same patent that is in dispute in the DirecTV and Comcast lawsuits. On October 24, 2006, the Company filed a motion to dismiss the action for lack of a justiciable controversy. The Court denied the Company s motion on September 25, 2007. The Company filed its answer and counterclaim on October 10, 2007. No scheduling order has been entered in the case, and discovery has not yet begun.

XM/Sirius Litigation

On April 27, 2007, the Company filed an action for patent infringement in the United States District Court for the Eastern District of Texas, Lufkin Division, against XM Satellite Radio Holdings, Inc., XM Satellite Radio, Inc., and XM Radio, Inc. (collectively, XM), and Sirius Satellite Radio, Inc. and Satellite CD Radio, Inc. (collectively, Sirius). Judge Clark, the same judge who presided over the DirecTV trial, has been assigned to the case. The lawsuit alleges that XM and Sirius have infringed and continue to infringe the Company s 505 patent and seeks an injunction to prevent further infringement, actual damages to be proven at trial, enhanced damages for willful infringement and attorneys fees. The defendants filed an answer denying infringement of the 505 patent and asserting invalidity and other defenses. The defendants also moved to stay the case pending the outcome of the DirectTV appeal and the re-examination of the 505 patent described below. Judge Clark The defendants motion for a stay was denied. Discovery is now underway. The claim construction hearing has been set for February 6, 2008, and the trial has been set for September 15, 2008.

Requests for Re-Examination of the 505 Patent

Three requests for re-examination of the Company s 505 patent have been filed with the United States Patent and Trademark Office (PTO). The 505 patent is the patent that is in dispute in the DirecTV, EchoStar, Comcast and XM/Sirius lawsuits. On December 11, 2006, the PTO entered an order granting the first request and, on March 21, 2007, the PTO entered an order granting the second request. The third request, filed on August 1, 2007, was partially granted on September 28, 2007. The Company expects that the PTO will take steps to consolidate these requests into one request for re-examination. Alternately, the PTO may consolidate the first two requests and keep the third separate because it is directed to different claims than the first two requests. During the re-examination, some or all of the claims in the 505 patent could be invalidated or revised to narrow their scope, either of which could have a material adverse impact on the Company s position in the DirecTV, EchoStar, Comcast and XM/Sirius lawsuits. Resolution of one or more re-examination requests of the 505 Patent is likely to take more than 15 months.

Securities Class Action

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased the Company s common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, the Company s President and Chief Executive Officer, Frank H. Levinson, the Company s former Chairman of the Board and Chief Technical Officer, Stephen K. Workman, the Company s Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for the Company s initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company s stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company s stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of the Company s stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied defendants motion to dismiss the complaint. In July 2004, the Company and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs would dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers would be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, the Company would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under the Company s insurance policy, which may be up to $2 million. The timing and amount of payments that the Company could be required to make under the proposed settlement would depend on several factors, principally the timing and amount of any payment that the insurers may be required to make pursuant to the $1 billion guaranty. The Court gave preliminary approval to the settlement in February 2005 and held a hearing in April 2006 to consider final approval of the settlement. Before the Court issued a final decision on the settlement, on December 5, 2006, the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of the plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied the plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Subsequently, and consistent with these developments, the Court entered an order, at the request of the plaintiffs and issuers, to deny approval of the settlement, and the plaintiffs filed an amended complaint

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in an attempt to comply with the decision of the Second Circuit Court of Appeals. If an amended or modified settlement is not reached, and thereafter approved by the Court, the Company intends to defend the lawsuit vigorously. Because of the inherent uncertainty of litigation, however, the Company cannot predict its outcome. If, as a result of this dispute, the Company is required to pay significant monetary damages, its business would be substantially harmed.

The Company cannot predict the outcome of the legal proceedings discussed above. No amount of loss, if any, is considered probable or measurable and no loss contingency has been recorded at the balance sheet date.

15. Guarantees and Indemnifications

In November 2002, the FASB issued Interpretation No. 45 *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligations it assumes under that guarantee. As permitted under Delaware law and in accordance with the Company s Bylaws, the Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The Company may terminate the indemnification agreements with its officers and directors upon 90 days written notice, but termination will not affect claims for indemnification relating to events occurring prior to the effective date of termination. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that may enable it to recover a portion of any future amounts paid.

The Company enters into indemnification obligations under its agreements with other companies in its ordinary course of business, including agreements with customers, business partners, and insurers. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company s activities or the use of the Company s products. These indemnification provisions generally survive termination of the underlying agreement. In some cases, the maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited.

The Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has not recorded any liabilities for these agreements as of July 29, 2007. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements.

16. Subsequent Events

Future Impact of Certain Stock Option Restatement Items

Because virtually all holders of options issued by the Company were neither involved in nor aware of its accounting treatment of stock options, the Company has taken and intends to take actions to deal with certain adverse tax consequences that may be incurred by the holders of certain incorrectly priced options. The primary adverse tax consequence is that incorrectly priced stock options vesting after December 31, 2004 may subject the option holder to a penalty tax under Internal Revenue Code Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). The Company presently estimates that it will incur a liability to option holders of approximately $7.0 million, of which approximately $5.7 million will be recognized as additional stock compensation expense in future periods.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Forward-Looking Statements

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of many factors, including those set forth in Part II, Item 1A. Risk Factors below. The following discussion should be read together with our consolidated financial statements and related notes thereto included elsewhere in this report.

Business Overview

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Our optical subsystems consist primarily of transceivers which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances of 70 meters to 200 kilometers. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. Our manufacturing operations are vertically integrated and include internal manufacturing, assembly and test capability. We sell our optical subsystem and component products to manufacturers of storage and networking equipment such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company, Huawei and Qlogic.

We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and, to a lesser degree, to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell these products primarily to leading storage equipment manufacturers such as Brocade, EMC, Emulex, Hewlett-Packard Company, IBM and Qlogic.

Critical Accounting Policies

The preparation of our financial statements and related disclosures require that we make estimates, assumptions and judgments that can have a significant impact on our net revenue and operating results, as well as on the value of certain assets, contingent assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements and, therefore, consider these to be our critical accounting policies. See Note 1 to our consolidated financial statements included elsewhere in this report for more information about these critical accounting policies, as well as a description of other significant accounting policies.

Income Taxes

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An interpretation of FASB Statement No. 109,* (FIN 48) on May 1, 2007. FIN 48 is an interpretation of FASB Statement 109, *Accounting for Income Taxes,* and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a more likely than not threshold. In accordance with our accounting policy, we recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. This policy did not change as a result of our adoption on FIN 48.

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Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the periods indicated:

	Three Months Ended July 29, 2007	July 30, 2006
	(Unaudited)	
Revenues:		
Optical subsystems and components	91.1%	90.4%
Network test and monitoring systems	8.9	9.6
Total revenues	100.0	100.0
Cost of revenues	67.8	66.6
Amortization of acquired developed technology	1.6	1.4
Gross profit	30.6	32.0
Operating expenses:		
Research and development	16.6	13.5
Sales and marketing	9.5	8.3
General and administrative	7.6	7.1
Amortization of purchased intangibles	0.4	0.3
Total operating expenses	34.1	29.2
Income (loss) from operations	(3.5)	2.8
Interest income	1.3	1.2
Interest expense	(4.0)	(3.7)
Other income (expense), net	(0.1)	(0.3)
Income (loss) before income taxes and cumulative effect of change in accounting principle	(6.3)	0.0
Provision for income taxes	0.6	0.6
Net income (loss) before cumulative effect of adopting change in accounting principle	(6.9)	(0.6)
Cumulative effect of adopting change in accounting principle, net of tax	0.0	(1.1)
Net income (loss)	(6.9)%	0.5%

Revenues. Revenues decreased $508,000, or 0.5%, to $105.7 million in the quarter ended July 29, 2007 compared to $106.2 million in the quarter ended July 30, 2006. Sales of optical subsystems and components and network test and monitoring systems represented 91.1% and 8.9%, respectively, of total revenues in the quarter ended July 29, 2007, compared to 90.4% and 9.6%, respectively, in the quarter ended July 30, 2006.

Optical subsystems and components revenues increased $317,000 or 0.3%, to $96.4 million in the quarter ended July 29, 2007 compared to $96.0 million in the quarter ended July 30, 2006. While total optical subsystem revenue was relatively flat between the years, we experienced large fluctuations in our broad product categories. Sales of products for short distance LAN/SAN applications decreased $13.2 million, or 21.1%, to $49.4 million in the quarter ended July 29, 2007 compared to $62.6 million in the quarter ended July 30, 2006. The decline in product sales for LAN/SAN applications was primarily the result of a broad slowdown in unit sales to our SAN customers combined with competitive pricing pressure. Sales of products for longer distance MAN applications increased $13.5 million, or 40.4%, to $47.0 million in the quarter ended July 29, 2007 compared to $33.5 million in the quarter ended July 30, 2006. The increase in sales for MAN products was primarily the result of increased sales of our XFP product for 10Gbps applications.

Network test and monitoring systems revenues decreased $825,000, or 8.1%, to $9.4 million in the quarter ended July 29, 2007 compared to $10.2 million in the quarter ended July 30, 2006.

Amortization of Acquired Developed Technology. Amortization of acquired developed technology, a component of cost of revenues, increased $210,000, or 13.8%, in the quarter ended July 29, 2007 to $1.7 million compared to $1.5 million in the quarter ended July 30, 2006. The increase was the result of amortizing purchased technology acquired with the acquisitions of AZNA LLC and Kodeos Communications in the fourth quarter of fiscal 2007.

Gross Profit. Gross profit decreased $1.7 million, or 5.0%, to $32.3 million in the quarter ended July 29, 2007 compared to $34.0 million in the quarter ended July 30, 2006. Gross profit as a percentage of total revenue was 30.6% in the quarter ended July 29, 2007 compared to 32.0% in the quarter ended July 30, 2006. We recorded charges of $3.8 million for obsolete and excess inventory in the quarter ended July 29, 2007 and $3.4 million in the quarter ended July 30, 2006. We sold inventory that was written-off in previous periods resulting in a benefit of $1.7 million in the quarter ended July 29, 2007 and $1.1 million in the quarter ended July 30, 2006. As

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a result, we recognized a net charge of $2.1 million in the quarter ended July 29, 2007 compared to $2.3 million in the quarter ended July 30, 2006. Manufacturing overhead costs included stock-based compensation expenses of $722,000 in the quarter ended July 29, 2007 compared to $1.1 million in the quarter ended July 30, 2006. Excluding the amortization of acquired developed technology, the net impact of excess and obsolete inventory charges and stock-based compensation expenses, gross profit would have been $36.9 million, or 34.9% of revenue, in the quarter ended July 29, 2007 compared to $39.0 million, or 36.7% of revenue in the quarter ended July 30, 2006. The decrease in the adjusted gross profit margin was primarily due to the combined effect of flat revenue, flat manufacturing overhead expenses, and lower average sales prices on maturing products, partially offset by lower material costs.

Research and Development Expenses. Research and development expenses increased $3.1 million, or 21.6%, to $17.5 million in the quarter ended July 29, 2007 compared to $14.4 million in the quarter ended July 30, 2006. The increase was primarily due to personnel related charges of $1.7 million and development materials and outside services of $872,000. Approximately $1.1 million of the increase in research and development expenses was due to our acquisitions of AZNA LLC and Kodeos Communications in the prior quarter with the remaining increase resulting primarily from new 10GB and 40GB product development. Research and development expenses include stock-based compensation charges of $955,000 in the quarter ended July 29, 2007 and $1.2 million in the quarter ended July 30, 2006. Research and development expenses as a percent of revenues increased to 16.6% in the quarter ended July 29, 2007 compared to 13.5% in the quarter ended July 30, 2006.

Sales and Marketing Expenses. Sales and marketing expenses increased $1.2 million, or 13.8%, to $10.1 million in the quarter ended July 29, 2007 compared to $8.8 million in the quarter ended July 30, 2006. The increase was primarily due to increased personnel related costs, including travel, of $766,000, to develop and support anticipated future sales growth. Commission expense increased $188,000 due to product mix, as certain 10GB products have higher commission rates. Cost of evaluation units increased $187,000 in our Network Test and Monitoring business unit in an effort to stimulate enterprise sales in this segment. Sales and marketing expenses include stock-based compensation charges of $451,000 in the quarter ended July 29, 2007 and $529,000 in the quarter ended July 30, 2006. Sales and marketing expenses as a percent of revenues increased to 9.5% in the quarter ended July 29, 2007 compared to 7.1% in the quarter ended July 30, 2006.

General and Administrative Expenses. General and administrative expenses increased $477,000, or 6.3%, to $8.0 million in the quarter ended July 29, 2007 compared to $7.5 million in the quarter ended July 30, 2006. The increase was primarily due to an increase in personnel related costs, of which, approximately $120,000 was related to the acquisition of AZNA and Kodeos. Additionally, in the quarter ended July 29, 2007, we incurred fees associated with our stock option investigation of $1.2 million which were offset by a decrease in legal fees associated with patent infringement litigation. General and administrative expenses include stock-based compensation charges of $631,000 in the quarter ended July 29, 2007 and $607,000 in the quarter ended July 30, 2006. General and administrative expenses as a percent of revenues increased to 7.6% in the quarter ended July 29, 2007 compared to 7.1% in the quarter ended July 30, 2006.

Amortization of Purchased Intangibles. Amortization of purchased intangibles increased $191,000, or 63.9%, to $490,000 in the quarter ended July 29, 2007 compared to $299,000 in the quarter ended July 30, 2006. The increase was due to the acquisition of AZNA and Kodeos in the fourth quarter of fiscal 2007.

Interest Income. Interest income increased $160,000, or 12.7%, to $1.4 million in the quarter ended July 29, 2007 compared to $1.2 million in the quarter ended July 30, 2006. The increase was due to increased investment balances and interest rates.

Interest Expense. Interest expense increased $325,000, or 8.3%, to $4.2 million in the quarter ended July 29, 2007 compared to $3.9 million in the quarter ended July 30, 2006. Of total interest expense included in the quarter ended July 29, 2007, approximately $2.6 million related to our convertible subordinated notes due in 2008 and 2010 and $1.2 million represented a non-cash charge to amortize the beneficial conversion feature of the 2008 notes. The increase in interest expense, between quarters, was primarily due to the interest recorded in the quarter ended July 29, 2007 related to convertible notes in the amount of $17.0 million, bearing interest at 5% per annum, that were issued upon the acquisition of AZNA in the fourth quarter of fiscal 2007.

Other Income (Expense), Net. Other expense was $133,000 in the quarter ended July 29, 2007 compared to $370,000 in the quarter ended July 30, 2006. Other expense primarily consists of amortization of subordinated loan costs offset by the gain on the sale of an equity investment in the quarter ended July 29, 2007. Other expense primarily consists of our proportional share of losses associated with a minority investment and amortization of subordinated loan costs, partially offset by a foreign exchange gain in the quarter ended July 30, 2006.

Provision for Income Taxes. We recorded income tax provisions of $621,000 and $631,000, respectively, for the quarters ended July 29, 2007 and July 30, 2006. The income tax provision for these periods is primarily the result of establishing a deferred tax liability to reflect tax amortization of goodwill for which no book amortization has occurred. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset potential income tax benefits associated with our operating losses. As a result, we did not record any income tax benefit in the quarters ended July 2007 or 2006. There can be no assurance that deferred tax assets subject to the valuation allowance will ever be realized.

We adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), in the first quarter of 2007. See Income Taxes in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q for further discussion.

Liquidity and Capital Resources

At July 29, 2007, cash, cash equivalents and short-term and long-term available-for-sale investments were $129.3 million compared to $132.5 million at April 30, 2006. Of this amount at July 29, 2007, long-term available-for-sale investments totaled $17.3 million of which $9.1 million was related to debt securities which were readily saleable and $8.2 million related to the conversion of an equity method investment to available-for-sale although there are market restrictions on our ability to sell the security underlying this investment. Restricted securities, used to secure future interest payments on our convertible debt were $625,000 at July 29, 2007 and April 30, 2006. At July 29, 2007, total short and long term debt was $268.3 million, compared to $267.6 million at April 30, 2006.

Net cash provided by operating activities totaled $3.5 million in the quarter ended July 29, 2007, compared to $8.5 million in the quarter ended July 30, 2006. Cash provided by operating activities for the quarter ended July 29, 2007 was primarily a result of operating losses adjusted for depreciation, amortization and non-cash related items in the income statement totaling $5.6 million offset by $2.1 million in additional working capital most of which was related to an increase in accounts receivable and a decrease in accounts payable. The cash provided by operating activities for the quarter ended July 30, 2006 was primarily a result of operating losses adjusted for depreciation, amortization and non-cash related items in the income statement totaling $13.9 million offset by $5.4 million related to lower working capital requirements primarily resulting from an increase in accounts receivable.

Net cash used in investing activities totaled $7.0 million in the quarter ended July 29, 2007 compared to $9.5 million in the quarter ended July 30, 2006. Cash invested in the quarters ended July 2007 and 2006 was primarily related equipment purchases to support production expansion and the purchase of short-term investments.

Net cash used by financing activities totaled $549,000 in the quarter ended July 29, 2007 compared to net cash provided by financing activities of $1.1 million in the quarter ended July 30, 2006. Cash used by financing activities for the quarter ended July 29, 2007 was due to repayments of borrowings. Cash provided by financing activities in quarter ended July 30, 2006 was primarily due to proceeds from the exercise of stock options and sales of stock under the employee stock purchase plan of $1.7 million partially offset by repayments on borrowings of $597,000.

We believe that our existing balances of cash, cash equivalents and short-term investments, together with the cash expected to be generated from our future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may however require additional financing to fund our operations in the future. A significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operations will be adversely affected.

Contractual Obligations and Commercial Commitments

At July 29, 2007, we had contractual obligations of $345.1 million as shown in the following table (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**
Short-term debt	$ 1,925	$ 1,925	$	$	$
Long-term debt	5,146		4,206	940	
Convertible debt	267,200	66,950	100,250	100,000	
Interest on debt	18,586	9,318	8,004	1,264	

Lease commitment under sale-leaseback agreement	44,703	3,114	6,439	6,732	28,418
Operating leases	4,912	2,213	2,500	199	
Purchase obligations	2,676	2,676			
Total contractual obligations	$ 345,148	$ 86,196	$ 121,399	$ 109,135	$ 28,418

Short-term debt of $1.9 million represents the current portion of a note payable to a financial institution.

Long-term debt consists of the long-term portion of a note payable to a financial institution in the principal amount of $5.1 million.

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Convertible debt consists of a series of convertible subordinated notes in the aggregate principal amount of $100.3 million due October 15, 2008, and two series of convertible subordinated notes in the aggregate principal amount of $150.0 million due October 15, 2010. The notes are convertible by the holders of the notes at any time prior to maturity into shares of Finisar common stock at specified conversion prices. The notes are redeemable by us, in whole or in part. Annual interest payments on the convertible subordinated notes are approximately $9.0 million annually.

Interest on debt consists of the scheduled interest payments on our short-term, long-term, and convertible debt.

The lease commitment under sale-leaseback agreement includes the principal amount of $11.9 million related to the sale-leaseback of our corporate office building, which we entered into in the fourth quarter of fiscal 2005.

Operating lease obligations consist primarily of base rents for facilities we occupy at various locations.

Purchase obligations consist of standby repurchase obligations and are related to materials purchased and held by subcontractors on our behalf to fulfill the subcontractors purchase order obligations at their facilities. Our repurchase obligations of $2.7 million have been expensed and recorded on the balance sheet as non-cancelable purchase obligations as of July 29, 2007.

On November 1, 2007, the Company entered into an amended letter of credit reimbursement agreement with Silicon Valley Bank that will be available to the Company through October 26, 2008. The terms of the new amended agreement are substantially unchanged from the previous agreement, although, the bank has waived the SEC filing requirement covenant until the Company is current with its filing requirements. Under the terms of the amended agreement, Silicon Valley Bank is providing a $15 million letter of credit facility covering existing letters of credit issued by Silicon Valley Bank and any other letters of credit that may be required by us. Outstanding letters of credit secured by this agreement at July 29, 2007 totaled $11.3 million.

Off-Balance-Sheet Arrangements

At July 29, 2007 and April 30, 2007, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk.***

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. We place our investments with high credit issuers in short-term securities with maturities ranging from overnight up to 36 months or have characteristics of such short-term investments. The average maturity of the portfolio will not exceed 18 months. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign exchange risk.

We invest in equity instruments of privately held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when our ownership interest is less than 20% and we do not have the ability to exercise significant influence. For entities in which we hold greater than a 20% ownership interest, or where we have the ability to exercise significant influence, we use the equity method. For these non-quoted investments, our policy is to regularly review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses when events and circumstances indicate that such assets are impaired. If our investment in a privately-held company becomes marketable equity securities upon the company s completion of an initial public offering or its acquisition by another company, our investment would be subject to significant fluctuations in fair market value due to the volatility of the stock market. There has been no material change in our interest rate exposure since April 30, 2007.

Item 4. ***Controls and Procedures.***

Evaluation of Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during the first quarter of fiscal 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. ***Legal Proceedings***

Matters Related to Historical Stock Option Grant Practices

On November 30, 2006, we announced that we had undertaken a voluntary review of our historical stock option grant practices subsequent to our initial public offering in November 1999. The review was initiated by senior management, and preliminary results of the review were discussed with the Audit Committee of our Board of Directors. Based on the preliminary results of the review, senior management concluded, and the Audit Committee agreed, that it was likely that the measurement dates for certain stock option grants differed from the recorded grant dates for such awards and that we would likely need to restate our historical financial statements to record non-cash charges for compensation expense relating to some past stock option grants. The Audit Committee thereafter conducted a further investigation and engaged independent legal counsel and financial advisors to assist in that investigation. The Audit Committee concluded that measurement dates for certain option grants differ from the recorded grant dates for such awards. Our management, in conjunction with the Audit Committee, conducted a further review to finalize revised measurement dates and determine the appropriate accounting adjustments to our historical financial statements, which are reflected in this report. The announcement of the investigation, and related delays in filing this quarterly report on Form 10-Q for the quarter ended January 28, 2007 (the January 10-Q), our quarterly report on Form 10-Q for the quarters ended October 29, 2006 (the October 10-Q) and July 29, 2007 (the July 10-Q) and our annual report on Form 10-K for the fiscal year ended April 30, 2007 (the 2007 10-K), have resulted in the initiation of regulatory proceedings as well as civil litigation and claims.

Nasdaq Determination of Non-compliance

On December 13, 2006, we received a Staff Determination notice from the Nasdaq Stock Market stating that the Company was not in compliance with Marketplace Rule 4310(c)(14) because we did not timely file the October 10-Q and, therefore, that our common stock was subject to delisting from the Nasdaq Global Select Market. We received similar Staff Determination Notices with respect to our failure to timely file the January 10-Q, the July 10-Q and the 2007 10-K. In response to the original Staff Determination Notice, we requested a hearing before a Nasdaq Listing Qualifications Panel (the Panel) to review the Staff Determination and to request additional time to comply with the filing requirements pending completion of the Audit Committee s investigation. The hearing was held on February 15, 2007. The Company thereafter supplemented its previous submission to Nasdaq to include the subsequent periodic reports in its request for additional time to make required filings. On April 4, 2007, the Panel granted us additional time to comply with the filing requirements until June 11, 2007 for the October 10-Q and until July 3, 2007 for the January 10-Q. We appealed the Panel s decision to the Nasdaq Listing and Hearing Review Counsel (the Listing Council), seeking additional time to make the filings. On May 18, 2007, the Listing Council agreed to review the Panel s April 4, 2007 decision and stayed that decision pending review of our appeal. On October 5, 2007, the Listing Council granted us an exception until December 4, 2007 to file our delinquent periodic reports and restatement. On November 26, 2007, we filed an appeal with the Nasdaq Board of Directors seeking a review of the Listing Council s decision and a stay of the decision, including the Listing Council s December 4, 2007 deadline. On November 30, 2007, the Nasdaq Board of Directors agreed to review the Listing Council s decision and stayed the decision pending further consideration. We believe that the filing of this report, and the simultaneous filing of the other delinquent reports on Form 10-K and Form 10-Q, will satisfy the conditions of the Listing Council s decision and that our common stock will continue to be listed on the Nasdaq Global Select Market.

Securities and Exchange Commission Inquiry

In November 2006, we informed the staff of the SEC of the voluntary investigation that had been undertaken by the Audit Committee of our Board of Directors. We were subsequently notified by the SEC that the SEC was conducting an informal inquiry regarding our historical stock option grant practices. We are cooperating with the SEC s review.

Stock Option Derivative Litigation

Following our announcement on November 30, 2006 that the Audit Committee of the Board of Directors had voluntarily commenced an investigation of our historical stock option grant practices, we were named as a nominal defendant in several shareholder derivative cases. These cases have been consolidated into two proceedings pending in federal and state courts in California. The federal court cases have been consolidated in the United States District Court for the Northern District of California. The state court cases have been consolidated in the Superior Court for the State of California for the County of Santa Clara. Plaintiffs in all cases have alleged that certain of our current or former officers and directors caused us to grant stock options at less than fair market value, contrary to our public statements (including statements in our financial statements), and that, as a result, those officers and directors are liable to the Company. No specific amount of damages has been alleged and, by the nature of the lawsuits no damages will be alleged, against the Company. On May 22, 2007, the state court granted our motion to stay the state court action pending resolution of the consolidated federal court action. On June 12, 2007, the plaintiffs in the federal court case filed an amended complaint to reflect the results of the stock option investigation announced by the Audit Committee in June 2007. On August 28, 2007, we and the individual defendants filed motions to dismiss the complaint. A hearing on the motions has been set for January 11, 2008.

Trust Indenture Litigation

On January 4, 2007, we received three substantially identical purported notices of default from U.S. Bank Trust National Association, as trustee (the Trustee) for our 2 1/2% Convertible Senior Subordinated Notes due 2010, our 2 1/2% Convertible Subordinated Notes due 2010 and our 5 1/4% Convertible Subordinated Notes due 2008 (collectively, the Notes). The notices asserted that our failure to timely file the October 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the three indentures between us and the Trustee governing the respective series of Notes (the Indentures). The notices each indicated that, if we did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. As previously reported, we had delayed filing the October 10-Q pending the completion of the review of our historical stock option grant practices conducted by the Audit Committee of its Board of Directors.

We do not believe that we are in default under the terms of the Indentures. We contend that the plain language of each Indenture requires only that we file with the Trustee reports that have actually been filed with the SEC, and that, since the October 10-Q had not yet been filed with the SEC, we were under no obligation to file it with the Trustee.

In anticipation of the expiration of the 60 day cure period under the notices on March 5, 2007, and the potential assertion by the Trustee or the noteholders that an Event of Default had occurred and a potential attempt to accelerate payment on one or more series of the Notes, on March 2, 2007, we filed a lawsuit in the Superior Court for the State of California for the County of Santa Clara against U.S. Bank Trust National Association, solely in its capacity as Trustee under the Indentures, seeking a judicial declaration that we are not in default under the three Indentures, based on our position as described above. The Trustee filed an answer to the complaint generally denying all allegations and also filed a notice of removal of the state case to the United States District Court for the Northern District of California. On October 12, 2007, the action was remanded back to state court in which it was commenced because the Trustee s notice of removal was not timely.

As expected, on March 16, 2007, we received three additional notices from the Trustee asserting that Events of Default under the Indentures had occurred and were continuing based on our failure to cure the alleged default within the 60 day cure period.

On April 24, 2007, we received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that our failure to timely file the January 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. The notices each indicated that, if we did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. We do not believe that we are in default under the terms of the Indentures for the reasons described above.

On June 21, 2007, we filed a second declaratory relief action against the Trustee in the Superior Court of California for the County of Santa Clara. The second action is essentially identical to the first action filed on March 2, 2007 except that it covers the notices asserting Events of Default received in April 2007 and any other notices of default that the Trustee may deliver in the future with respect to our delay in filing, and providing copies to the Trustee, of periodic reports with the SEC. The Trustee filed an answer to the complaint generally denying all allegations and filed a notice of removal to the United States District Court for the Northern District of California. We have filed a motion to remand to state court, which was heard and taken under submission on November 2, 2007.

On July 9, 2007, we received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that our failure to timely file this Form 10 K report with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. As before, the notices each indicated that, if we did not cure the purported default within 60 days, an Event of Default would occur under the respective Indenture. We do not believe that we are in default under the terms of the Indentures for the reasons described above.

To date, neither the Trustee nor the holders of at least 25% in aggregate principal amount of one or more series of the Notes have declared all unpaid principal, and any accrued interest, on the Notes to be due and payable, although the Trustee stated in its notices that it reserved the right to exercise all available remedies. As of October 31, 2007, there was $250.3 million in aggregate principal amount of Notes outstanding and an aggregate of approximately $558,000 in accrued interest.

Patent Litigation

DirecTV Litigation

On April 4, 2005, we filed an action for patent infringement in the United States District Court for the Eastern District of Texas against the DirecTV Group, Inc., DirecTV Holdings, LLC, DirecTV Enterprises, LLC, DirecTV Operations, LLC, DirecTV, Inc., and Hughes Network Systems, Inc. (collectively, DirecTV). The lawsuit involves our U.S. Patent No. 5,404,505 (the 505 patent), which relates to technology used in information transmission systems to provide access to a large database of information. On June 23, 2006, following a jury trial, the jury returned a verdict that our patent had been willfully infringed and awarded us damages of $78,920,250. In a post-trial hearing held on July 6, 2006, the Court determined that, due to DirecTV s willful infringement, those damages would be enhanced by an additional $25 million. Further, the Court awarded us pre-judgment interest on the jury s verdict in the amount of 6% compounded annually from April 4, 1999, amounting to approximately $13.4 million. Finally, the Court awarded us costs of $147,282 associated with the litigation. The Court declined to award us attorney s fees. The Court denied our motion for injunctive relief, but ordered DirecTV to pay us a compulsory ongoing license fee at the rate of $1.60 per set-top box activated by or on behalf of DirecTV for the period beginning June 16, 2006 through the duration of the patent, which expires in April 2012. The Court entered final judgment in our favor and against DirecTV on July 7, 2006. On September 1, 2006, the Court denied DirecTV s post-trial motions seeking to have the jury verdict set aside or reversed and requesting a new trial on a number of grounds. In another written post-trial motion, DirecTV asked the Court to allow DirecTV to place any amounts owed to us under the compulsory license into an escrow account pending the outcome of any appeal and for those amounts to be refundable in the event that DirecTV prevails on appeal. The Court granted DirecTV s motion, and payments under the compulsory license are being made into an escrow account pending the outcome of the appeal. As of October 12, 2007, DirecTV has deposited approximately $28 million into escrow. These escrowed funds represent DirecTV s compulsory royalty payments for the period from June 17, 2006 through September 30, 2007.

DirecTV has appealed to the United States Court of Appeals for the Federal Circuit. In its appeal, DirecTV raised issues related to claim construction, infringement, invalidity, willful infringement and enhanced damages. We cross-appealed raising issues related to the denial of our motion for permanent injunction, the trial court s refusal to enhance future damages for willfulness and the trial court s determination that some of the asserted patent claims are invalid. The appeals have been consolidated. The parties were ordered to participate in the appellate court s mandatory mediation program, which occurred on February 13, 2007 without resolution. The parties have filed their respective briefs with the appellate court. A neutral third party, New York Intellectual Property Law Association (NYIPLA) filed an *amicus* brief urging the appellate court to vacate the portion of trial court s judgment denying our motion for a permanent injunction and ordering DirecTV to pay royalties pursuant to a compulsory license. Over DirecTV s objection, the appellate court accepted NYIPLA s *amicus* brief.

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On November 19, 2007, the Court of Appeals denied NYIPLA s motion to file a reply brief. Oral arguments have been set for January 7, 2008. Subsequent to the oral arguments, it is anticipated that a decision from the appellate court will issue between March 2008 and November 2008.

Comcast Litigation

On July 7, 2006, Comcast Cable Communications Corporation, LLC (Comcast) filed a complaint against us in the United States District Court, Northern District of California, San Francisco Division. Comcast seeks a declaratory judgment that our 505 patent is not infringed and is invalid. The 505 patent is the same patent alleged by us in our lawsuit against DirecTV. Our motion to dismiss the declaratory judgment action was denied on November 9, 2006. As a result, on November 22, 2006, we filed an answer and counterclaim alleging that Comcast infringes the 505 patent and seeking damages to be proven at trial. The court held a claim construction hearing and, on April 6, 2007, issued its claim construction ruling. Discovery is now underway. The parties have been ordered to a mediation and settlement conference on December 13, 2007. A jury trial has been scheduled for March 3, 2008.

EchoStar Litigation

On July 10, 2006, EchoStar Satellite LLC, EchoStar Technologies Corporation and NagraStar LLC (collectively, EchoStar) filed an action against us in the United States District Court for the District of Delaware seeking a declaration that EchoStar does not infringe, and has not infringed, any valid claim of our 505 patent. The 505 patent is the same patent that is in dispute in the DirecTV and Comcast lawsuits. On October 24, 2006, we filed a motion to dismiss the action for lack of a justiciable controversy. The Court denied our motion on September 25, 2007. We filed our answer and counterclaim on October 10, 2007. No scheduling order has been entered in the case, and discovery has not yet begun.

XM/Sirius Litigation

On April 27, 2007, we filed an action for patent infringement in the United States District Court for the Eastern District of Texas, Lufkin Division, against XM Satellite Radio Holdings, Inc., XM Satellite Radio, Inc., and XM Radio, Inc. (collectively, XM), and Sirius Satellite Radio, Inc. and Satellite CD Radio, Inc. (collectively, Sirius). Judge Clark, the same judge who presided over the DirecTV trial, has been assigned to the case. The lawsuit alleges that XM and Sirius have infringed and continue to infringe our 505 patent and seeks an injunction to prevent further infringement, actual damages to be proven at trial, enhanced damages for willful infringement and attorneys fees. The defendants filed an answer denying infringement of the 505 patent and asserting invalidity and other defenses. The defendants also moved to stay the case pending the outcome of the Direct TV appeal and the re-examination of the 505 patent described below. The defendants motion for a stay was denied. Discovery is now underway. The claim construction hearing has been set for February 6, 2008, and the trial has been set for September 15, 2008.

Requests for Re-Examination of the 505 Patent

Three requests for re-examination of our 505 patent have been filed with the United States Patent and Trademark Office (PTO). The 505 patent is the patent that is in dispute in the DirecTV, EchoStar, Comcast and XM/Sirius lawsuits. On December 11, 2006, the PTO entered an order granting the first request and, on March 21, 2007, the PTO entered an order granting the second request. The third request, filed on August 1, 2007, was partially granted on September 28, 2007. We expect that the PTO will take steps to consolidate these requests into one request for re-examination. Alternately, the PTO may consolidate the first two requests and keep the third separate because it is directed to different claims than the first two requests. During the re-examination, some or all of the claims in the 505 patent could be invalidated or revised to narrow their scope, either of which could have a material adverse impact on our position in the DirecTV, EchoStar, Comcast, XM/Sirius lawsuits. Resolution of one or more re-examination requests of the 505 Patent is likely to take more than 15 months.

Securities Class Action

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, our President and Chief Executive Officer, Frank H. Levinson, our former Chairman of the Board and Chief Technical Officer, Stephen K. Workman, our Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000.

The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of our stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of our stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of our stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied defendants motion to dismiss the complaint. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs would dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers would be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement would depend on several factors, principally the timing and amount of any payment that the insurers may be required to make pursuant to the $1 billion guaranty. The Court gave preliminary approval to the settlement in February 2005 and held a hearing in April 2006 to consider final approval of the settlement. Before the Court issued a final decision on the settlement, on December 5, 2006, the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of the plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied the plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Subsequently, and consistent with these developments, the Court entered an order, at the request of the plaintiffs and issuers, to deny approval of the settlement, and the plaintiffs filed an amended complaint in an attempt to comply with the decision of the Second Circuit Court of Appeals. The plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the Second Circuit decision. If an amended or modified settlement is not reached, and thereafter approved by the Court, we intend to defend the lawsuit vigorously. Because of the inherent uncertainty of litigation, however, we cannot predict its outcome. If, as a result of this dispute, we are required to pay significant monetary damages, our business would be substantially harmed.

Item 1A. Risk Factors

OUR FUTURE PERFORMANCE IS SUBJECT TO A VARIETY OF RISKS, INCLUDING THOSE DESCRIBED BELOW. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCUR, OUR BUSINESS COULD BE HARMED AND THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE. YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED IN THIS REPORT, INCLUDING OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES. THE RISK FACTORS DESCRIBED BELOW DO NOT CONTAIN ANY MATERIAL CHANGES FROM THOSE DISCLOSED IN ITEM 1A OF OUR ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED APRIL 30, 2007.

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We have incurred significant net losses, our future revenues are inherently unpredictable, our operating results are likely to fluctuate from period to period, and if we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly

We incurred net losses of $45.4 million, $33.0 million and $117.7 million in our fiscal years ended April 30, 2007, 2006 (as restated) and 2005 (as restated), respectively. Our operating results for future periods are subject to numerous uncertainties, and we cannot assure you that we will be able to achieve or sustain profitability on a consistent basis.

Our quarterly and annual operating results have fluctuated substantially in the past and are likely to fluctuate significantly in the future due to a variety of factors, some of which are outside of our control. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of future performance. Some of the factors that could cause our quarterly or annual operating results to fluctuate include market acceptance of our products, market demand for the products manufactured by our customers, the introduction of new products and manufacturing processes, manufacturing yields, competitive pressures and customer retention.

We may experience a delay in generating or recognizing revenues for a number of reasons. Orders at the beginning of each quarter typically represent a small percentage of expected revenues for that quarter and are generally cancelable at any time. Accordingly, we depend on obtaining orders during each quarter for shipment in that quarter to achieve our revenue objectives. Failure to ship these products by the end of a quarter may adversely affect our operating results. Furthermore, our customer agreements typically provide that the customer may delay scheduled delivery dates and cancel orders within specified timeframes without significant penalty. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues could significantly harm our business. It is likely that in some future quarters our operating results will again decrease from the previous quarter or fall below the expectations of securities analysts and investors. In this event, it is likely that the trading price of our common stock would significantly decline.

We may have insufficient cash flow to meet our debt service obligations, including payments due on our subordinated convertible notes

We will be required to generate cash sufficient to conduct our business operations and pay our indebtedness and other liabilities, including all amounts due on our outstanding $2^1/2$% convertible senior subordinated notes due 2010 totaling $100 million, our $2^1/2$% convertible subordinated notes due 2010 totaling $50 million, and our $5^1/4$% convertible subordinated notes due 2008 totaling $100 million. In addition, the $100 million in principal amount of our $2^1/2$% convertible senior subordinated notes that mature in October 2010 include a net share settlement feature under which we are required to pay the principal portion of the notes in cash upon conversion. We may not be able to cover our anticipated debt service obligations from our cash flow. This may materially hinder our ability to make payments on the notes. Our ability to meet our future debt service obligations will depend upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Accordingly, we cannot assure you that we will be able to make required principal and interest payments on the notes when due.

If we are unsuccessful in pending litigation, our payment obligations under our outstanding convertible subordinated notes could be accelerated

The Trustee for all of our outstanding convertible subordinated notes has notified us that, in the opinion of the Trustee, we are in default under the indentures governing the respective series of notes as a result of our failure to timely file periodic reports with the Securities and Exchange Commission (the SEC). Although neither the Trustee nor the holders of any of the notes have declared the unpaid principal, and accrued interest, on any of the notes to be due and payable, the Trustee has stated in its notices that it reserves the right to exercise all available remedies, which would include acceleration of the notes. We do not believe that we were in default under the terms of the indentures on the basis that the plain language of each indenture requires only that we file with the Trustee reports that have actually been filed with the SEC and that, since the reports in question have not yet been filed with the SEC, we are under no obligation to file them with the Trustee. In anticipation of the assertion by the Trustee or the noteholders that Events of Default had occurred, and a potential attempt to accelerate payment on one or more series of the notes, we instituted litigation seeking a judicial declaration that we are not in default under the indentures. Should we be unsuccessful in this litigation, the Trustee or the noteholders could attempt to accelerate payment on one or more series of the notes. As of October 31, 2007, there was $250.3 million in aggregate principal amount of Notes outstanding and an aggregate of approximately $558,000 in accrued interest.

We may not be able to obtain additional capital in the future, and failure to do so may harm our business

We believe that our existing balances of cash, cash equivalents and short-term investments will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months, unless our payment obligations under our outstanding convertible subordinated notes is accelerated. We may, however, require additional financing to fund our operations in the future or to repay the principal of our outstanding convertible subordinated notes. Due to the unpredictable nature of the capital markets, particularly in the technology sector, we cannot assure you that we will be able to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, we could be required to significantly reduce or restructure our business operations.

Failure to accurately forecast our revenues could result in additional charges for obsolete or excess inventories or non-cancelable purchase commitments

We base many of our operating decisions, and enter into purchase commitments, on the basis of anticipated revenue trends which are highly unpredictable. Some of our purchase commitments are not cancelable, and in some cases we are required to recognize a charge representing the amount of material or capital equipment purchased or ordered which exceeds our actual requirements. In the past, we have sometimes experienced significant growth followed by a significant decrease in customer demand such as occurred in fiscal 2001, when revenues increased by 181% followed by a decrease of 22% in fiscal 2002. Based on projected revenue trends during these periods, we acquired inventories and entered into purchase commitments in order to meet anticipated increases in demand for our products which did not materialize. As a result, we recorded significant charges for obsolete and excess inventories and non-cancelable purchase commitments which contributed to substantial operating losses in fiscal 2002. Should revenue in future periods again fall substantially below our expectations, or should we fail again to accurately forecast changes in demand mix, we could be required to record additional charges for obsolete or excess inventories or non-cancelable purchase commitments.

If we encounter sustained yield problems or other delays in the production or delivery of our internally-manufactured components or in the final assembly and test of our transceiver products, we may lose sales and damage our customer relationships

Our manufacturing operations are highly vertically integrated. In order to reduce our manufacturing costs, we have acquired a number of companies, and business units of other companies, that manufacture optical components incorporated in our optical subsystem products and have developed our own facilities for the final assembly and testing of our products. For example, we design and manufacture many critical components including all of the short wavelength VCSEL lasers incorporated in transceivers used for LAN/SAN applications at our wafer fabrication facility in Allen, Texas and manufacture a portion of our internal requirements for longer wavelength lasers at our wafer fabrication facility located in Fremont, California. We assemble and test most of our transceiver products at our facility in Ipoh, Malaysia. As a result of this vertical integration, we have become increasingly dependent on our internal production capabilities. The manufacture of critical components, including the fabrication of wafers, and the assembly and testing of our products, involve highly complex processes. For example, minute levels of contaminants in the manufacturing environment, difficulties in the fabrication process or other factors can cause a substantial portion of the components on a wafer to be nonfunctional. These problems may be difficult to detect at an early stage of the manufacturing process and often are time-consuming and expensive to correct. From time to time, we have experienced problems achieving acceptable yields at our wafer fabrication facilities, resulting in delays in the availability of components. Poor manufacturing yields over a prolonged period of time could adversely affect our ability to deliver our subsystem products to our customers and could also affect our sale of components to customers in the merchant market. Our inability to supply enough lasers or other key components to meet our internal needs could harm our relationships with customers and have an adverse effect on our business.

We may lose sales if our suppliers or independent contractors fail to meet our needs

We currently purchase several key components used in the manufacture of our products from single or limited sources, and we rely on a single independent contract manufacturer to supply us with certain key subassemblies, including printed circuit boards. We depend on these sources to meet our production needs. Moreover, we depend on the quality of the components and subassemblies that they supply to us, over which we have limited control. We have encountered shortages and delays in obtaining components in the past and expect to encounter additional shortages and delays in the future. If we cannot supply products due to a lack of components, or are unable to redesign products with other components in a timely manner, our business will be significantly harmed. We generally have no long-term contracts with any of our component suppliers or contract manufacturers. As a result, a supplier or contract manufacturer can discontinue supplying components or subassemblies to us without penalty. If a supplier were to discontinue supplying a key component, our business may be harmed by the resulting product manufacturing and delivery delays. We are also subject to potential delays in the development by our suppliers of key components which may affect our ability to introduce new products. Similarly, disruptions in the services provided by our contract manufacturers or the transition to other suppliers of these services could lead to supply chain problems or delays in the delivery of our products. These problems or delays could damage our relationships with our customers and adversely affect our business.

We use rolling forecasts based on anticipated product orders to determine our component and subassembly requirements. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may have excess inventory, which would increase our costs. If we underestimate our component requirements, we may have inadequate inventory, which could interrupt our manufacturing and delay delivery of our products to our customers. Any of these occurrences would significantly harm our business.

We are dependent on widespread market acceptance of two product families, and our revenues will decline if the market does not continue to accept either of these product families

We currently derive substantially all of our revenue from sales of our optical subsystems and components and network test and monitoring systems. We expect that revenue from these products will continue to account for substantially all of our revenue for the foreseeable future. Accordingly, widespread acceptance of these products is critical to our future success. If the market does not continue to accept either our optical subsystems and components or our network test and monitoring systems, our revenues will decline significantly. Factors that may affect the market acceptance of our products include the continued growth of the markets for LANs, SANs and MANs and, in particular, Gigabit Ethernet and Fibre Channel-based technologies, as well as the performance, price and total cost of ownership of our products and the availability, functionality and price of competing products and technologies.

Many of these factors are beyond our control. In addition, in order to achieve widespread market acceptance, we must differentiate ourselves from our competition through product offerings and brand name recognition. We cannot assure you that we will be successful in making this differentiation or achieving widespread acceptance of our products. Failure of our existing or future products to maintain and achieve widespread levels of market acceptance will significantly impair our revenue growth.

We depend on large purchases from a few significant customers, and any loss, cancellation, reduction or delay in purchases by these customers could harm our business

A small number of customers have consistently accounted for a significant portion of our revenues. For example, sales to our top five customers represented 40% of our revenues in fiscal 2007. Our success will depend on our continued ability to develop and manage relationships with significant customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future.

The markets in which we sell our optical subsystems and components products are dominated by a relatively small number of systems manufacturers, thereby limiting the number of our potential customers. Our dependence on large orders from a relatively small number of customers makes our relationship with each customer critically important to our business. We cannot assure you that we will be able to retain our largest customers, that we will be able to attract additional customers or that our customers will be successful in selling their products that incorporate our products. We have in the past experienced delays and reductions in orders from some of our major customers. In addition, our customers have in the past sought price concessions from us, and we expect that they will continue to do so in the future. Cost reduction measures that we have implemented over the past several years, and additional action we may take to reduce costs, may adversely affect our ability to introduce new and improved products which may, in turn, adversely affect our relationships with some of our key customers. Further, some of our customers may in the future shift their purchases of products from us to our competitors or to joint ventures between these customers and our competitors. The loss of one or more of our largest customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may make could significantly harm our business.

Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet our customers needs

Typically, we do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

- our customers can stop purchasing our products at any time without penalty;
- our customers are free to purchase products from our competitors; and
- our customers are not required to make minimum purchases.

Sales are typically made pursuant to individual purchase orders, often with extremely short lead times. If we are unable to fulfill these orders in a timely manner, it is likely that we will lose sales and customers.

Our market is subject to rapid technological change, and to compete effectively we must continually introduce new products that achieve market acceptance

The markets for our products are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards with respect to the protocols used in data communications networks. We expect that new technologies will emerge as competition and the need for higher and more cost-effective bandwidth increases. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address these changes as well as current and potential customer requirements. For example, we expect the SAN market to begin migrating from 4 Gbps to 8 Gbps product solutions in fiscal 2008 and that our ability to achieve sustained revenue growth in the markets for LAN, MAN and telecom applications will depend to a large extent on our ability to successfully develop and introduce new 10 Gbps transceiver and transponder solutions during this same period. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. In addition, a slowdown in demand for existing products ahead of a new product introduction could result in a write-down in the value of inventory on hand related to existing products. We have in the past experienced a slowdown in demand for existing products and delays in new product development and such delays may occur in the future. To the extent customers defer or cancel orders for existing products due to a slowdown in demand or in the expectation of a new product release or if there is any delay in development or introduction of our new products or enhancements of our products, our operating results would suffer. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, or to license these technologies from third parties. Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- unanticipated engineering complexities;
- expense reduction measures we have implemented, and others we may implement, to conserve our cash and attempt to achieve and sustain profitability;
- difficulties in hiring and retaining necessary technical personnel;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- changing market or competitive product requirements.

The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards. Any failure to respond to technological change would significantly harm our business.

Continued competition in our markets may lead to a reduction in our prices, revenues and market share

The end markets for optical products have experienced significant industry consolidation during the past few years while the industry that supplies these customers has not. As a result, the markets for optical subsystems and components and network test and monitoring systems for use in LANs, SANs and MANs are highly competitive. Our current competitors include a number of domestic and international companies, many of which have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. We may not be able to compete successfully against either current or future competitors. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business. For optical subsystems, we compete primarily with Avago Technologies, JDS Uniphase, Intel, Opnext, Optium, Sumitomo and a number of smaller vendors. For network test and monitoring systems, we compete primarily with Agilent Technologies and LeCroy. Our competitors continue to introduce improved products and we will have to do the same to remain competitive.

Decreases in average selling prices of our products may reduce gross margins

The market for optical subsystems is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and increased unit volumes as manufacturers continue to deploy network and storage systems. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. We anticipate that average selling prices will decrease in the future in response to product introductions by competitors or us, or by other factors, including price pressures from significant customers. Therefore, in order to achieve and sustain profitable operations, we must continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross margins to decline, which would result in additional operating losses and significantly harm our business.

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in redesigning our products or delivering our products to market in a timely manner. We cannot assure you that any redesign will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margins.

Shifts in our product mix may result in declines in gross margins

Our gross profit margins vary among our product families, and are generally higher on our network test and monitoring systems than on our optical subsystems and components. Our optical products sold for longer distance MAN and telecom applications typically have higher gross margins than our products for shorter distance LAN or SAN applications. Our gross margins are generally lower for newly introduced products and improve as unit volumes increase. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce product costs, and these fluctuations are expected to continue in the future.

Our customers often evaluate our products for long and variable periods, which causes the timing of our revenues and results of operations to be unpredictable

The period of time between our initial contact with a customer and the receipt of an actual purchase order may span a year or more. During this time, customers may perform, or require us to perform, extensive and lengthy evaluation and testing of our products before purchasing and using them in their equipment. Our customers do not typically share information on the duration or magnitude of these qualification procedures. The length of these qualification processes also may vary substantially by product and customer, and, thus, cause our results of operations to be unpredictable. While our potential customers are qualifying our products and before they place an order with us, we may incur substantial research and development and sales and marketing expenses and expend significant management effort. Even after incurring such costs we ultimately may not sell any products to such potential customers. In addition, these qualification processes often make it difficult to obtain new customers, as customers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources. Once our products have been qualified, the agreements that we enter into with our customers typically contain no minimum purchase commitments. Failure of our customers to incorporate our products into their systems would significantly harm our business.

We depend on facilities located outside of the United States to manufacture a substantial portion of our products, which subjects us to additional risks

In addition to our principal manufacturing facility in Malaysia, we operate smaller facilities in China and Singapore and rely on two contract manufacturers located in Asia for our supply of key subassemblies. Each of these facilities and manufacturers subjects us to additional risks associated with international manufacturing, including:

- unexpected changes in regulatory requirements;
- legal uncertainties regarding liability, tariffs and other trade barriers;
- inadequate protection of intellectual property in some countries;
- greater incidence of shipping delays;
- greater difficulty in overseeing manufacturing operations;

greater difficulty in hiring talent needed to oversee manufacturing operations;

potential political and economic instability; and

the outbreak of infectious diseases such as severe acute respiratory syndrome, or SARS, which could result in travel restrictions or the closure of our facilities or the facilities of our customers and suppliers.

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Any of these factors could significantly impair our ability to source our contract manufacturing requirements internationally.

Our future operating results may be subject to volatility as a result of exposure to foreign exchange risks.

We are exposed to foreign exchange risks. Foreign currency fluctuations may affect both our revenues and our costs and expenses and significantly affect our operating results. Prices for our products are currently denominated in U.S. dollars for sales to our customers throughout the world. If there is a significant devaluation of the currency in a specific country relative to the dollar, the prices of our products will increase relative to that country s currency, our products may be less competitive in that country and our revenues may be adversely affected.

Although we price our products in U.S. dollars, portions of both our cost of revenues and operating expenses are incurred in foreign currencies, principally the Malaysian ringit and the Chinese yuan. As a result, we bear the risk that the rate of inflation in one or more countries will exceed the rate of the devaluation of that country s currency in relation to the U.S. dollar, which would increase our costs as expressed in U.S. dollars. To date, we have not engaged in currency hedging transactions to decrease the risk of financial exposure from fluctuations in foreign exchange rates.

Our business and future operating results are subject to a wide range of uncertainties arising out of the continuing threat of terrorist attacks and ongoing military actions in the Middle East

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of the continuing threat of terrorist attacks on the United States and ongoing military actions in the Middle East, including the economic consequences of the war in Iraq or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

- increased risks related to the operations of our manufacturing facilities in Malaysia;
- greater risks of disruption in the operations of our China and Singapore facilities and our Asian contract manufacturers and more frequent instances of shipping delays; and
- the risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities.

Past and future acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results

Since October 2000, we have completed the acquisition of ten privately-held companies and certain businesses and assets from six other companies. We continue to review opportunities to acquire other businesses, product lines or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities, and we from time to time make proposals and offers, and take other steps, to acquire businesses, products and technologies.

Several of our past acquisitions have been material, and acquisitions that we may complete in the future may be material. In 12 of our 16 acquisitions, we issued common stock or notes convertible into common stock as all or a portion of the consideration. The issuance of stock in any future transactions would dilute our stockholders percentage ownership.

Other risks associated with acquiring the operations of other companies include:

- problems assimilating the purchased operations, technologies or products;
- unanticipated costs associated with the acquisition;
- diversion of management s attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience; and

potential loss of key employees of purchased organizations.

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Not all of our past acquisitions have been successful. During fiscal 2003, we sold some of the assets acquired in two prior acquisitions, discontinued a product line and closed one of our acquired facilities. As a result of these activities, we incurred significant restructuring charges and charges for the write-down of assets associated with those acquisitions. We cannot assure you that we will be successful in overcoming problems encountered in connection with future acquisitions, and our inability to do so could significantly harm our business. In addition, to the extent that the economic benefits associated with any of our acquisitions diminish in the future, we may be required to record additional write downs of goodwill, intangible assets or other assets associated with such acquisitions, which would adversely affect our operating results.

We have made and may continue to make strategic investments which may not be successful, may result in the loss of all or part of our invested capital and may adversely affect our operating results

Through fiscal 2007, we recorded minority equity investments in early-stage technology companies, totaling $52.4 million. Our investments in these early stage companies were primarily motivated by our desire to gain early access to new technology. We intend to review additional opportunities to make strategic equity investments in pre-public companies where we believe such investments will provide us with opportunities to gain access to important technologies or otherwise enhance important commercial relationships. We have little or no influence over the early-stage companies in which we have made or may make these strategic, minority equity investments. Each of these investments in pre-public companies involves a high degree of risk. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and failure by the early-stage company to achieve its own business objectives or to raise capital needed on acceptable economic terms could result in a loss of all or part of our invested capital. In fiscal 2003, we wrote off $12.0 million in two investments which became impaired. In fiscal 2004, we wrote off $1.6 million in two additional investments, and in fiscal 2005, we wrote off $10.0 million in another investment. During fiscal 2006, we reclassified $4.2 million of an investment associated with the Infineon acquisition to goodwill as the investment was deemed to have no value. We may be required to write off all or a portion of the $11.3 million in such investments remaining on our balance sheet as of April 30, 2007 in future periods.

We face risks of regulatory actions and inquiries into our historical stock option grant practices and related accounting, which could require significant management time and attention, and that could have a material adverse effect on our business, results of operations and financial condition

As a result of our investigation into our historical stock option grant practices and the restatement of our prior financial statements, we may be subject to greater risks associated with litigation, regulatory proceedings and government inquiries and enforcement actions, as described in Item 3. Legal Proceedings. We have voluntarily informed the SEC of the results of this investigation, and have been cooperating with, and continue to cooperate with, inquiries from the SEC. We are unable to predict what consequences, if any, that any inquiry by any regulatory agency may have on us. Any civil or criminal action commenced against us by a regulatory agency could result in administrative orders against us, the imposition of significant penalties and/or fines against us, and/or the imposition of civil or criminal sanctions against certain of our officers, directors and/or employees. Any regulatory action could result in the filing of additional restatements of our prior financial statements or require that we take other actions, and could divert management s attention from other business concerns and harm our business.

We have been named as a party to derivative action lawsuits, and we may be named in additional litigation, all of which will require significant management time and attention and result in significant legal expenses and may result in an unfavorable outcome which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We have been named as a nominal defendant in several purported shareholder derivative lawsuits concerning the granting of stock options. These cases have been consolidated into two proceedings pending in federal and state courts in California. The federal court cases have been consolidated in the United States District Court for the Northern District of California. The state court cases have been consolidated in the Superior Court for the State of California for the County of Santa Clara. Plaintiffs in all cases have alleged that certain current or former officers and directors of the Company caused it to grant stock options at less than fair market value, contrary to our public statements (including statements in our financial statements), and that, as a result, those officers and directors are liable to the

Company. No specific amount of damages has been alleged and, by the nature of the lawsuits no damages will be alleged, against the Company. On May 22, 2007, the state court granted our motion to stay the state court action pending resolution of the consolidated federal court action. On June 12, 2007, the plaintiffs in the federal court case filed an amended complaint to reflect the results of the stock option investigation announced by the Audit Committee in June 2007. On August 28, 2007, we and the individual defendants filed motions to dismiss the complaint. A hearing on the motions has been set for December 7, 2007. We cannot predict whether these actions are likely to result in any material recovery by, or expense to, us. We expect to continue to incur legal fees in responding to these lawsuits, including expenses for the reimbursement of legal fees of present and former officers and directors under indemnification obligations. The expense of defending such litigation may be significant. The amount of time to resolve these and any additional lawsuits is unpredictable and these actions may divert management s attention from the day-to-day operations of our business, which could adversely affect our business, results of operations and cash flows.

We are subject to other pending legal proceedings

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, certain of our current and former officers, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied defendants motion to dismiss the complaint. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs would dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers would be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay our pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement would depend on several factors, principally the timing and amount of any payment that the insurers may be required to make pursuant to the $1 billion guaranty. While the court was considering final approval of the settlement, the Second Circuit Court of Appeals vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. All proceedings in all of the lawsuits have been stayed, and the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the Second Circuit decision. There is no assurance that the settlement will be amended or renegotiated to comply with the Second Circuit s ruling, and then approved. If the settlement is not amended or renegotiated and subsequently approved by the Court, we intend to defend the lawsuit vigorously. Because of the inherent uncertainty of litigation, however, we cannot predict its outcome. If, as a result of this dispute, we are required to pay significant monetary damages, our business would be substantially harmed.

Because of competition for technical personnel, we may not be able to recruit or retain necessary personnel

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, technical, sales and marketing, finance and manufacturing personnel. In particular, we may need to increase the number of technical staff members with experience in high-speed networking applications as we further develop our product lines. Competition for these highly skilled employees in our industry is intense. Our failure to attract and retain these qualified employees could significantly harm our business. The loss of the services of any of our qualified employees, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel could hinder the development and introduction of and negatively impact our ability to sell our products. In addition, employees may leave our company and subsequently compete against us. Moreover, companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We have been subject to claims of this type and may be subject to such claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

Our failure to protect our intellectual property may significantly harm our business

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements to establish and protect our proprietary rights. We license certain of our proprietary technology, including our digital diagnostics technology, to customers who include current and potential competitors, and we rely largely on provisions of our licensing agreements to protect our intellectual property rights in this technology. Although a number of patents have been issued to us, we have obtained a number of other patents as a result of our acquisitions, and we have filed applications for additional patents, we cannot assure you that any patents will issue as a result of pending patent applications or that our issued patents will be upheld. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues. Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult and expensive. We are currently engaged in pending litigation to enforce certain of our patents, and additional litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. In connection with the pending litigation, substantial management time has been, and will continue to be, expended. In addition, we have incurred, and we expect to continue to incur, substantial legal expenses in connection with these pending lawsuits. These costs and this diversion of resources could significantly harm our business.

Claims that we infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products

The networking industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We have been involved in the past as a defendant in patent infringement lawsuits. From time to time, other parties may assert patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Any claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could significantly harm our business. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Our products may contain defects that may cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers

Our products are complex and defects may be found from time to time. Networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. In addition, our products are often embedded in or deployed in conjunction with our customers products which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

Our business and future operating results may be adversely affected by events outside our control

Our business and operating results are vulnerable to events outside of our control, such as earthquakes, fire, power loss, telecommunications failures and uncertainties arising out of terrorist attacks in the United States and overseas. Our corporate headquarters and a portion of our manufacturing operations are located in California. California in particular has been vulnerable to natural disasters, such as earthquakes, fires and floods, and other risks which at times have disrupted the local economy and posed physical risks to our property. We are also dependent on communications links with our overseas manufacturing locations and would be significantly harmed if these links were interrupted for any significant length of time. We presently do not have adequate redundant, multiple site capacity if any of these events were to occur, nor can we be certain that the insurance we maintain against these events would be adequate.

The conversion of our outstanding convertible subordinated notes would result in substantial dilution to our current stockholders

We currently have outstanding 2$^{1}/2$% convertible senior subordinated notes due 2010 in the principal amount of $100 million, 5$^{1}/4$% convertible subordinated notes due 2008 in the principal amount of $100.3 million, and 2$^{1}/2$% convertible subordinated notes due 2010 in the principal amount of $50 million. The 5$^{1}/4$% notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of $5.52 per share. The $50 million in principal amount of our 2$^{1}/2$% notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of $3.705 per share. The $100 million in principal amount of our 2$^{1}/2$% senior notes are convertible upon our stock price reaching $4.92 for a period of time, in which case the notes are convertible at a conversion rate of 304.9055 shares of common stock per $1,000 principal amount of notes, with the underlying principal payable in cash. An aggregate of approximately 42,000,000 shares of common stock would be issued upon the conversion all outstanding convertible subordinated notes at these exchange rates, which would significantly dilute the voting power and ownership percentage of our existing stockholders. We have previously entered into privately negotiated transactions with certain holders of our convertible subordinated notes for the repurchase of notes in exchange for a greater number of shares of our common stock than would have been issued had the principal amount of the notes been converted at the original conversion rate specified in the notes, thus resulting in more dilution. Although we do not currently have any plans to enter into similar transactions in the future, if we were to do so there would be additional dilution to the voting power and percentage ownership of our existing stockholders.

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Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders

Some provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These include provisions:

- authorizing the board of directors to issue additional preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder actions by written consent;
- creating a classified board of directors pursuant to which our directors are elected for staggered three-year terms;
- permitting the board of directors to increase the size of the board and to fill vacancies;
- requiring a super-majority vote of our stockholders to amend our bylaws and certain provisions of our certificate of incorporation; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which limit the right of a corporation to engage in a business combination with a holder of 15% or more of the corporation s outstanding voting securities, or certain affiliated persons.

In addition, in September 2002, our board of directors adopted a stockholder rights plan under which our stockholders received one share purchase right for each share of our common stock held by them. Subject to certain exceptions, the rights become exercisable when a person or group (other than certain exempt persons) acquires, or announces its intention to commence a tender or exchange offer upon completion of which such person or group would acquire, 20% or more of our common stock without prior board approval. Should such an event occur, then, unless the rights are redeemed or have expired, our stockholders, other than the acquirer, will be entitled to purchase shares of our common stock at a 50% discount from its then-Current Market Price (as defined) or, in the case of certain business combinations, purchase the common stock of the acquirer at a 50% discount.

Although we believe that these charter and bylaw provisions, provisions of Delaware law and our stockholder rights plan provide an opportunity for the board to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control, even under circumstances that some stockholders may consider beneficial.

Our stock price has been and is likely to continue to be volatile

The trading price of our common stock has been and is likely to continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors, including:

- trends in our industry and the markets in which we operate;
- changes in the market price of the products we sell;
- changes in financial estimates and recommendations by securities analysts;
- acquisitions and financings;

quarterly variations in our operating results;

the operating and stock price performance of other companies that investors in our common stock may deem comparable; and

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purchases or sales of blocks of our common stock.

Part of this volatility is attributable to the current state of the stock market, in which wide price swings are common. This volatility may adversely affect the prices of our common stock regardless of our operating performance.

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Item 6. ***Exhibits***

The following exhibits are filed herewith:

31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C.Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FINISAR CORPORATION

By: /s/ JERRY S. RAWLS

Jerry S. Rawls
Chairman of the Board, President and Chief Executive Officer

By: /s/ STEPHEN K. WORKMAN

Stephen K. Workman
Senior Vice President, Finance, Chief Financial Officer and Secretary

Dated: December 4, 2007

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EXHIBIT INDEX

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